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ECONOMIC CRISIS

RISING PRICES AND FALLING PRODUCTION

THE NATIONAL INFORMATION & PUBLICATIONS LTD
BOMBAY

FIRST PUBLISHED 1948

Printed and published by Kusum Nair for The National Informat
& Publications Ltd., National House, 6, Tulloch Rc
Apollo Bunder, Bombay.

PREFACE

THE SERIES

The object of these handbooks is to present in a simple ·anner different economic problems relating to India as ll as those in which India is likely to be interested. The ries will aim at covering the entire range of economic ·,roblems in course of time. Special attention will be given s far as possible to current topics. The treatment will be :ientific, and each handbook will be written by a person who has specialised in the particular subject and will, there-ore, be authoritative. The exposition will be such that it may be easy for the layman to understand the problem. The Series will thus stimulate interest in the complex and ıanging economic problems of the country and promote better understanding of the same. The need for an intelligent appreciation of such problems by the public under the new political conditions in the country is obvious, and it is hoped that this Series will supply that want.

THE HANDBOOK

The economic crisis, which may be briefly described as e of rising prices and falling production, has been deloping since the end of World War II, and has now as-.med serious proportions. The Government of India became onscious of the gravity of the situation and called together eral groups of persons for advice at short notice in August 48. Pointed attention was thus drawn to the problem, which the Government issued its statement of policy 4th October. To the layman, the problem naturally apırs complicated. Even politicians and administrators are .fled at the idea of having to cry halt to their schemes expenditure at a time when they were anxiously pushing ıward with them. A clear understanding of the problem required, if we are to deal with the emergency effectively ıd promptly, so that we may have that economic equiliium in the country in which to forge our plans of economic progress with success. This Handbook attempts at oviding in brief the necessary material to enable the reader follow the developments regarding this problem with terest.

The evolution of the problem has been briefly traced in Chapter I. The production crisis both in industry and agriculture has been discussed in Chapter II. The part played by different types of controls in checking inflation and the consequences of decontrol are briefly examined in Chapter III. Chapter IV deals with the nature and extent of deficit financing by Central and Provincial Governments in recent times. The way is thus prepared for an understanding of the increased monetary activity in Chapter V. The general effects of rising prices to society are explained in Chapter VI. So far as remedies are concerned, the report of the Economists who were asked to submit their suggestions on the present economic situation has been taken as the basis of Chapter VII. The anti-inflationary policy of the Government of India is examined briefly in Chapter VIII in the light of the recommendations of Economists discussed in the previous chapter. Certain current fallacies on the problem of inflation have been discussed in an Appendix; this was considered necessary in the interests of clear thinking on a problem which affects all classes of people.

Thanks are due to Mr. S. A. Pandit, Lecturer in Economics and Mr. T. M. Desai, Research Assistant in Economics for help in this work and more especially to Mr. V. R. Cirvante, Research Assistant in Economics who did valuable work in putting together the scattered material on the subject, and in seeing the book through the press. Thanks are also due to Dr. B. V. Krishnamurthy, Lecturer in Economics, for the Appendix. I am also indebted to the Editor of the Commerce for permission to use my article on Controls and Dr. Krishnamurthy's article on Monetary Fallacies, both first published in the *Commerce*, in Chapter III and in the Appendix respectively.

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10th October, 1948.

C. N. VAKIL

N.B. A few minor printing errors have unfortunately crept in. Readers are requested to note the corrections in 'Errata' given on p. 122.

CONTENTS

EVOLUTION OF THE PROBLEM

War-time Inflation

The way in which the huge war preparations in India were financed both on behalf of India and on behalf of the Allies is now well-known. The fact that this method of financing led to considerable inflation in the country with its usual evil consequences is also commonly accepted. Though for some time the inflationary situation was not noticed, when pointed attention to it was drawn mainly by Economists, a series of anti-inflationary measures were adopted in the summer of 1943 and thereafter. Though the various controls which came into existence in this way were only partially successful because of the apathy or even hostility of the public towards the control machinery, on the whole the controls did, to some extent, keep the inflation under control.

Depression Psychology

By the time the war was coming to an end, particularly in the latter part of 1945, there was a widespread belief both in Government circles and among the business community that the cessation of hostilities would be followed by a depression. The argument was that the economic activity during the war had been kept at a high pitch because of war time expenditure by the Government and the withdrawal of that expenditure would lead to unemployment and depression. It was, therefore, thought necessary to replace Government expenditure of this type by other expenditure which would keep up economic activity of the country and thus prevent the advent of depression. Those few who pointed out the possibility of a

postwar inflation were in a hopeless minority and were even ridiculed.* In order to implement these ideas the Government of India asked the Provinces and the various Departments at the Centre to go ahead with the schemes of capital expenditure, mainly of the nature of public works. In connection with the work of the Department of Planning, various plans, central and provincial, had been drawn up and those schemes which could be put into operation without delay were taken out from these plans. The Government of India promised substantial financial support and estimated that large amounts would be available for the purpose out of war time taxes and other resources. The same psychology was reflected in the idea that if war time taxes on business and industry were removed it would give an impetus to private enterprise to go in for more productive investment and thus help in preventing depression. With this end in view, in the Budget of 1946-47 Sir Archibald Rowlands gave substantial relief in taxation by the abolition of the E.P.T. and by the reduction of some other taxes amounting in the aggregate to a relief of about Rs. 32 crores.

Post-war Inflation

These expectations were, however, not realised. Instead of giving rise to productive enterprise, the purchasing power thus released found its way into the stock market where speculation was rampant. The plans of demobilisation took time and the expenditure of Government could not be reduced as speedily as it was anticipated. The pent up demand of different classes of people was now becoming effective and people began to demand more goods against

* In a Government of India Committee, consisting of economic experts and some officers, I found myself in a minority of one. *The Eastern Economist* ridiculed my views on the subject, though they were considered confidential, and I was not in a position to reply in view of my official position at the time as Economist to the Planning and Development Department.

this additional purchasing power. This was particularly so in the case of those who had made large gains in the black market. The effort to catch the black marketeer by the demonetisation of Rs. 1,000 notes did not prove successful. The decision to go ahead with large schemes of capital expenditure under such circumstances was bound to lead to higher prices. A policy of large public works expenditure which can be justified in times of depression is unwise under a state of affairs which is highly inflationary in itself. In other words, the timing of this expenditure was fundamentally wrong.

Taxation and Production

In the light of experience of what happened during the year 1946-47 and the realisation that the depression psychology was wrong, the Government of India decided in the Budget for 1947-48 to reimpose taxes on business and industry which had been unwisely removed in the previous year. By this time the composition of the Government had changed. An interim Congress-League Coalition was in power pending the settlement of the political issues. Accustomed to the relief in taxes in the previous year the business community got panicky about the taxes on business profits and on incomes, which were now imposed and they carried on propaganda against these taxes and did not even hesitate to mix up the current political tension with it. The main argument of the business community was that these taxes were likely to prove a dis-incentive to production and were, therefore, not desirable. This argument would have had some justification if the relief in taxes during 1946-47 had been followed by greater productive activity which, however, was not the case. In the absence of a definite proof of close relationship between these taxes and productive enterprise, it is difficult to assess the value of this propaganda. It is not impossible to find specific cases of hardship which may deserve special treatment, but it is difficult to lay down a general proposition that taxation of the nature imposed in 1947-48 had

the general effect of the type that was alleged.

This propaganda had, however, its effect. In his supplementary Budget in November 1947, Mr. Chetty took a note of it and promised to give full consideration to it. In his Budget for 1948-49, Mr. Chetty gave some relief in taxes and indicated that it was a gesture which would be followed up after due examination. Soon after this, the Industrial Policy statement of the Government of India was announced which was hailed by leading industrialists as satisfactory. In spite of these measures, the expected impetus to greater productive activity has not been visible in action.

Rising Prices

We thus find that in the postwar period we have, on the one hand, a fall in production or in some cases a stationary situation and, on the other, continuously rising prices. Among the causes of this rise in prices, continuation of deficit financing, increase in monetary media, the policy of decontrol and the continuous increase in salaries, wages and dearness allowances may be mentioned. The rise in prices has been somewhat spectacular since the policy of decontrol was introduced and has attracted widespread notice. * It has now been realised on all hands that this con-

* Index Numbers of Prices and Cost of Living

		Food Articles *	Agricultural Commodities†	General Index† (sensitive)	General Index * (General purpose)	Working Class cost of living (Bombay)‡
September	1945	—	264	242	—	231
,,	1947	296	347	398	302	285
March	1948	347	402	344	341	270
August	1948	377	444	—	383	292

* Base: Year ended August 1939 = 100. September 1945 figures are not available.

† Base: Week ended 19-8-1939 = 100. General Index (sensitive series) has been discontinued after March 1948.

‡ Base: August 1939 = 100.

tinuous spiral of rising prices cannot be followed up by a continuous rise in wages and salaries, that it is a serious handicap to industrial labour as well as to Government Budgets because their estimates completely get upset from time to time even as the budgets of individuals get upset at the same time. Labour leaders have realised that though they have succeeded in getting substantial monetary gains for the working classes in recent times, they are not better off because of rising prices. Therefore they are anxious to see that the tide is turned and the value of the money which the working classes receive rises thus giving them a better living wage. The business community, which ordinarily feels happy with rising prices because it makes them richer, has at last realised the fact that, after all, the nominal rise in their riches may ultimately be worth very little, that it is not in their own interests to have continuous unrest among the workers or to have continuously rising costs of production in their factories without a corresponding chance of obtaining a continuous higher price for their goods. The Government of India has realised in the midst of the many complex problems with which they are faced that this problem of rising prices makes their task exceedingly difficult and that a remedy should be found without delay to prevent a further deterioration in the economic situation of the country. They have realised that the policy of decontrol was wrongly conceived and they have begun gradually taking steps towards establishing a machinery of control in essential goods by their recent measures of cloth and cotton control. This general appreciation of the inflationary situation in which the country is engulfed led the Government of India to summon different groups such as industrialists and labour leaders as well as economic experts at short notice to Delhi during August 1948 to suggest suitable measures. After due consideration, the Government of India announced its anti-inflationary policy on 4th October 1948.

CHAPTER II

PRODUCTION CRISIS

1. INDUSTRIAL PRODUCTION

Industrial production in India before the war was not sufficient to fulfil the requirements of the country and a considerable quantity of manufactured articles had to be imported. During the war there was some increase in industrial production but as a very large part of the output was diverted for military purposes, the civilian population had to do with a smaller supply of manufactured articles, particularly because of a virtual stoppage of the imports of consumers' goods. The diversion of the productive capacity of industries and the available supply of goods back to civilian requirements at the end of the war was expected to ease the situation. It was also expected that Indian industries would receive active state support with the establishment of the National Government and that industrialisation would make rapid strides. India was also aspiring to develop the economies of Asian countries with the help of Indian capital. The actual course of events has, however, been thoroughly disappointing. The Minister of Industry and Supply pointed out in his opening speech at the Industries Conference in December 1947: "Almost since the end of the war, but more particularly from August 1946 there has been a steady decline in industrial production. The decline has been so serious that some have wondered whether we should not for a while forget further industrial development and concentrate our efforts on bringing installed capacity now lying idle upto its fullest possible working." In other words, plans of large-scale industrial development may have to be set aside until the existing industries have been brought back to their normal level.

Index of Industrial Output in India *

(Base : year ended Aug. 1939 = 100)

1939-40	110.3
1940-41	114.2
1941-42	123.2
1942-43	125.5
1943-44	126.8
1944-45	121.7
1945-46	120.0
1946-47	105.0
1947-48	105.3

According to the above index number, industrial output went on increasing during the war period until it reached the maximum in 1943-44. After that it registered a steady decline, the fall being serious in 1946-47 and 1947-48, when the level of production was even below the level reached in 1939-40.

The table on page 8 shows that the production of most industries in the postwar period is below the average level of production during the war. When compared with the peak level attained during the war, the fall in production is significant. The downward trend becomes clear from the fact that production in 1946-47 was lower than that in 1945-46. The 1947-48 figures show a further decline in some industries. † Almost all the major industries have registered lower output, the situation being particularly serious in respect of cotton textiles, cement, iron and steel, wheat flour, sugar and paper. Many industries are working below their installed capacity at a time when there is an

* This index is issued by the *Eastern Economist.*

† Though Pakistan areas have been excluded from August 1947, this omission is likely to affect the data relating to only wheat flour and cement production to a considerable extent. In respect of other industries Pakistan's share is negligible.

Industrial and Mineral Production

Items	Average of 1939-45	Peak figure and year	1945–46	1946–47	1947–48*
Cotton piece goods (Mlln. yds.)	4,414	4,871 (1943-44)	4,676	3,863	3,756
Jute manufactures (000 tons)	1,103	1,259 (1941-42)	973	1,042	1,059
Cement (000 tons)	2,004	2,183 (1942-43)	2,146	2,017	1,004
Sulphuric Acid (000 cwts.)	781	858 (1941-42)	481	593	588
Ammonium sulphate (000 tons)	25	30 (1941-42)	21	22	22
Wheat flour (Mlln. Mds.)	15.7	18.2 (1941-42)	14.7	6.8	4.7
Sugar (Mlln. cwts.)	21.8	22.5 (1943-44)	16.9	16.1	15.3
Paper (000 cwts.)	1,800	1,959 (1942-43)	1,682	1,431	1,443
Matches (Mlln gross)	18.6	23.1 (1940-41)	20.0	15.9	18.0
Pig iron (000 tons)	1,768	1,804 (1942-43)	1,406	1,364	1,523
Steel ingots („)	1,275	1,366 (1943-44)	1,300	1,199	1,210
Finished steel („)	1,259	1,353 (1943-44)	1,338	1,169	788
Petrol (Mlln. Gls.)	26.4	30.6 (1944-45)	22.9†	21.4†	15.7†
Kerosene („)	27.3	41.7 (1940-41)	12.9†	13.4†	13.8†

* Figures for 1947-48 exclude Pakistan territories from August 1947.
† These figures are provisional.

urgent need for increased production. As regards mineral production the provisional figures for the post-war period show that petroleum production in 1946-47 was only two-thirds of the peak wartime production, while kerosene output was as low as one-third. Since Pakistan accounts for a considerable amount of petroleum output of undivided India, the Indian Union will experience a further shortage of petroleum. Coal will be discussed later, since the coal problem is mainly one of transport rather than of production.

The important factors responsible for this serious decline in output are: (1) The difficulty of obtaining capital equipment; (2) labour unrest; (3) transport difficulties; (4) shortage of coal; (5) insufficiency of raw material supplies; and (6) the paralysis of investment activity. The partition of the country has also been an important factor; instead of dealing separately with this factor, we have dealt with the consequences of the partition under the above heads.

Difficulty of Obtaining Capital Equipment

The capital equipment of most Indian industries was strained to the maximum during the war owing to the heavy pressure of urgent military requirements. Many factories were working extra shifts and machines, which required complete renewal and replacement even before the war, had to be continued longer in service, because foreign equipment was not available and India could not produce any. During the last nine or ten years there have been no appreciable renewals, and even maintenance and repairs have not been properly looked after. Industrialists had hopes of getting capital goods from abroad in the postwar period for replacement and extension purposes. But owing to world shortage, the prices of capital goods have risen enormously, and an interval of two or three years usually elapses between the booking of orders and their actual delivery.

The existing capital equipment can be made to last longer only through less intensive use of the machines. Industrial output has suffered as a consequence of decreased efficiency and less intensive use of industrial equipment.

Labour Unrest

The war time rise in the cost of living had led to the demand for dearness allowances on the part of wage-earners and salaried employees. Employers had in a large measure conceded these demands because they were in a position to pass on the increased cost of production to the consumers by charging higher prices. Prices did not show a downward tendency after the termination of the war; on the contrary, they rose further. The consequent continuous rise in the cost of living led to a steep fall in the real income of the workers. Thus, for example, between September 1945 and June 1948, that is, in a period of two years and nine months since the end of the war, the cost of living index number went up from 231 to 292 in Bombay and from 320 to 462 in Cawnpore, an increase of 61 and 142 points respectively. * There was, therefore, an organised and continuous demand for higher wages, dearness allowances and bonuses on the part of labourers in an attempt to neutralise the increased cost of living. But the employers hesitated to grant these claims because they were afraid of a recession and anticipated a fall in prices and profit margins. The outcome of this situation was widespread labour trouble and a spate of strikes in 1946-47. Some of the industrial disputes were stoutly fought in industrial and labour courts, which were established to settle these disputes. However, there was considerable dissatisfaction with the delay in the arbitration proceedings. The following table shows the increased incidence of stoppages due to industrial disputes in the postwar period.

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* Base: August 1939 = 100 for both Bombay & Cawnpore; *Indian Labour Gazette.*

Industrial Disputes during and after the war

Year	No. of disputes involving stoppages	No. of workers involved (000's)	No. of man-days lost (millions)
War Period :			
1939	406	409	5.0
1940	322	453	7.6
1941	359	291	3.3
1942	694	773	5.8
1943	716	525	2.3
1944	658	550	3.4
1945	820	748	4.1
Average of 1939-45.	567	535	4.5
Post-war Period.:			
1946	1,629	1,962	12.7
1947	2,251	2,352	16.5

The number of disputes, the number of workers involved and the number of man-days lost in 1946 were nearly thrice, and those in 1947 were nearly four times, the annual average for the war years. The number of workers involved crossed the million mark for the first time, being very nearly 2 millions in 1946 and nearly 2.4 millions in 1947. The number of workers involved was, in fact, more than 60% of the total number of factory workers in each of these two years. The total number of man-days lost in each of these years, 1946 and 1947, comes very near to the total number of man-days during the six years of war. Such a large scale stoppage of work was bound to have serious repercussions on industrial output. The cotton textile and iron and steel industries, as well as the railways, were the worst affected by labour trouble. Labour trouble also expressed itself in some cases in the form of go-slow policy, indispline, violence and increased abstenteeism, all of which resulted in inefficiency.

Although labour has managed to wrest large amounts of additional monetary rewards, it is not satisfied with its gains, and efforts are now being made to devise a profit-sharing scheme, whereby labour may also share in industrial profits. The Report of the Committee on Profit-sharing recommends an experimental scheme in selected industries. The higher remuneration secured by labour, however, has not been accompanied by a corresponding increase in its efficiency. To this extent, the cost of production has increased and this is likely to be passed on to the consumers in the form of higher prices. In so far as industrial workers are also consumers of other products, they are affected by the consequent rise in the cost of living.

The Government of India called for a truce between labour and capital in the interest of greater production at a Conference held in December 1947 between the representatives of employers and trade unions. Several efforts have been made to implement this truce. It is not clear, however, whether those who took part in this Conference realised that it was not a practical proposition to bring about such a truce so long as prices continued to rise. If the workers' budgets get continuously upset by rising prices, they are bound to ask for higher wages. They are also now accustomed to the methods by which they can demand and get what they want, irrespective of their efficiency. No amount of truce resolutions will be of avail so long as this fundamental factor in the situation is ignored.

Transport Problem

Transport bottlenecks, which hindered industrial production and efficient distribution of supplies during the war, still continue to obstruct the full utilisation of the potential productive capacity of Indian industries. The greatest handicap experienced by industries is the lack of transport to supply them with raw materials and fuel and to despatch finished goods.

The following table gives the tonnage carried by Indian railways since 1938-39:

Tonnage Carried by Railways in India

Year		million tons
1938-39	......	88
1939-40	......	92
1940-41	......	93
1941-42	......	97
1942-43	......	95
1943-44	......	97
1944-45	......	102
1945-46	......	101
1946-47	......	92

This shows that though the railways are moving more goods than before the war, the tonnage carried is very much below the peak level attained during the war. In this section we shall first consider the factors responsible for acute transport shortage and then examine the effect of such a situation on industrial production.

It is well known that railway equipment was overworked as a result of intensive war effort. Because of the dismantling and transfer of railway lines, as well as locomotives and rolling stock, to certain theatres of war outside India, the country suffered a net loss of equipment. The railways were at the same time undermaintained owing to the difficulty of obtaining replacements, spare parts and components for the construction of rolling stock as a result of the wartime strain on the productive capacity of the country. Improvement in the transport situation in the postwar period, which was expected to result from the diversion of railway stock from military to civilian use and the replacement of outworn equipment, did not materialise. Owing to world shortage of transport equipment, it has not been feasible to fulfil our rolling stock requirements by means of imports. As regards the railway workshops, which repair and overhaul the rolling stock, the position is very unsatisfactory and it is estimated that they are working

at an efficiency of about 50% only. This means that less number of wagons, coaches and locomotives can be reconditioned for service. In view of the shortage of wagons it is necessary to ensure their quick turn-round, but this has not been a practical proposition because of an acute scarcity of locomotives and the delay in the unloading of the wagons. The position in regard to passenger traffic is in no way better; with twice the pre-war number of passengers and 15% less capacity available, overcrowding which characterised wartime travel has now become a normal feature. The railways, along with other industries, have had their share of labour trouble resulting from postwar economic unrest. Sporadic strikes, which were declared illegal, were responsible for stoppages, particularly in the railway workshops. The operational efficiency of the railways has declined to such an extent that adherence to the time schedule is an exceptional rather than a normal feature on some of the railway systems. It must, however, not be forgotten that owing to the shortage of petrol and shipping difficulties, the railways have been called upon to to carry additional traffic which was formely being sent by road or sea.

Even before the partition of the country, the communal riots in Calcutta and the Punjab had resulted in a considerable disorganisation of the transport system. The partition created a grave emergency in Northern India and the railways, which were already in a bad plight, had to bear the severe strain of mass migration of refugees in the Punjab. The running of Refugee Specials entailed the cancellation for some time of all other passenger trains on the East Punjab Railway and of a number of trains on other railways. The railways, however, succeeded in moving nearly three million refugees in the short space of 2½ months immediately after the partition. Further transport was also necessary for the dispersal of evacuees from the refugee camps to their destination, for the movement of food, clothing and other stores for refugee relief, and for carrying the petrol necessary for speeding up evacuation by road and air. Local disturbances

led to a complete dislocation of goods traffic and the holding up of goods loading.

While these consequences followed directly from the Punjab disturbances, other changes resulting from the partition were having a more lasting effect on the working of the railways in the Indian Union. The railway staff having been granted the option to serve in either Dominion, 83,000 employees opted for service in Pakistan and 73,000 for service in the Indian Union. * The division of the staff according to different categories was very uneven, because Muslims had a predominent representation in essential categories like engine drivers and firemen, fitters and smiths. Thus there was a shortage of drivers and firemen to the extent of about 45% on the East Indian Railway as a result of which goods services had to be curtailed by one-third. † Before the partition, Karachi was the main port serving the requirements of Delhi, U. P. and the Punjab. Owing to the absence of another major port in Western India, almost the entire foreign trade on account of these provinces had to be diverted to Bombay. The change in the direction of traffic has increased the distance over which goods have now to be carried and has caused a congestion on the routes connecting Bombay with Northern India. The recent congestion of imported goods in the Bombay docks owing to transport difficulties indicates the magnitude of the problem. The Government of India wants to develop Kandla in Cutch into a major port, so that it may take the place formerly occupied by Karachi and relieve Bombay of its additional burden.

The decontrol of cloth and foodgrains also created an additional strain on the railways. Even before decontrol, there was the problem of movement of foodgrains from the port towns to the interior. As a result of decontrol the movement of foodgrains passed from the hands of the Government to private traders. A hihger priority had, therefore, to be granted for the movement of foodstuffs on

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* *Indian Information* : Independence Number, 1948, p. 55.
† Ibid.

private account and these were marked up from Class IV priority to Class II. While the Government could rationalise and plan the transport of foodstuffs so as to prevent cross movements, private traders indulged in a considerable amount of cross haulage of foodstuffs to take advantage of higher prices prevailing in scarcity areas. The average monthly movement of food wagons mounted up from 24,000 during the pre-decontrol quarter, October to December 1947, to 40,000 during the post-decontrol quarter, January to March 1948. * The Standing Committee of the Central Board of Transport was therefore called upon to plan these movements in order to minimise wasteful utilisation of the scarce transport service.

Coal

Nearly 20 to 25 per cent. of the railway goods traffic consists of coal movements. Since coal is vital for the working of our industries, any shortfall in respect of coal supplies is an impediment to industrial production. It is, therefore, distressing to note that although coal production shows a slight increase, transport bottlenecks have affected coal despatches, resulting in an accumulation of nearly one-fifth of the total coal raising at the pitheads in 1947-48.

	Raisings	Despatches	Difference
		(million tons)	
1944-45	24.2	20.9	3.3
1945-46	26.5	22.4	2.1
1946-47	26.2	22.7	3.5
1947-48	26.8	22.3	4.5

According to the Transport Minister, on an average, 150 out of 2,700 wagons remained unloaded daily in 1947 because no labour was available to load them or because stocks were not ready. Similarly, many wagons returned unloaded from different destinations because of shortage of labour to unload them. The shortage of drivers and firemen on the E. I. Railway as a result of staff transfers

* *Indian Information:* Independence Number, 1948, p. 56.

to Pakistan was also responsible for curtailing coal loadings by half for some period. In prewar days almost the entire supply of coal destined for Bombay and Kathiawar was sent by sea, but now it is mainly transported by rail because the shipping companies are charging higher rates. Though strikes and lockouts have affected coal production to some extent, the limiting factor has been the transport situation. Not only is there enough demand for all the coal produced in the country, but there is also need for an increase in coal output. But the accumulation of stocks at the pitheads has proceeded to such an extent that it is likely to choke further production at a time when increased output is urgently needed. If the industry is forced to curtail output and to close down some units, it will affect future capacity to produce and also lead to widespread unemployment of colliery labour.

The shortfall in coal movements has affected practically all industries. Intermittent supplies of coal have resulted in a depletion of fuel stocks of some factories to such an extent that curtailment of production became inevitable. Thus in 1947 the depletion of coal stocks of the Tata Iron and Steel factory necessitated the closing down of one blast furnace. Cement production also has been affected by coal shortage. The decline in the production of iron, steel and cement has increased the scarcity of construction materials. The cotton textiles industry is not working at full capacity even on the basis of two shifts, as against three shifts during the war, because of coal shortage and labour trouble. Paper and chemical industries also have suffered on account of coal shortage.

Raw Materials

The position in regard to the transport of raw materials is no better than in respect of coal. In 1948 the transport capacity available for raw material movements has been as low as one-third of the requirements of some important mills. Sugar factories in U.P. and the Titaghur Paper Mills in Bengal had to curtail production on account of

shortage of stocks. The unsatisfactory movement of raw cotton has affected cotton textile production.

The difficulties experienced in connection with raw materials are not confined to transport problems only. Owing to world shortage of raw materials there has been a keen foreign demand for raw materials. This has resulted in a rise in their prices, to which a further spurt was given by the policy of decontrol of raw material prices in the postwar period; at present they are almost twice as high as at the end of the war as shown in the following table.

Economic Adviser's Index Number—
Prices of Industrial Raw Materials.
(Base: Year ended Aug. 1939 = 100).

Month and Year	Index No.	Increase Over previous figure.
September 1945	238	
„ 1947	372	+ 134
August 1948	438	+ 66

The rise since September 1947 is to a large extent due to the acute scarcity of industrial raw materials, like raw cotton and jute, experienced in the Indian Union as a result of the Partition. The introduction of customs barriers has affected the free movement of commodities between the two Dominions and has brought into clear relief the effect on the loss of major raw material producing areas on Indian industries. Irregular supply of raw materials, on account of the various factors discussed above, has forced industries to curtail output, while the rise in their prices has served to raise the cost of production. Both these factors have served to add to the inflationary pressure on the economy of the country.

Paralysis of Investment Activity

One of the important causes of falling production is the lack of business confidence as a result of political and economic uncertainty. Industrialists in general have become

uneasy regarding taking active steps either to increase production or to undertake fresh ventures. The political situation in the country worsened in the postwar period, especially after the Calcutta disturbances in August 1946. After a year of sporadic disturbances in different parts of the country came the Punjab holocaust in August 1947. Even before the situation had subsided came the Kashmir war and the Hyderabad deadlock. The disturbed situation in the country resulted in a dislocation of trade and industrial activity. By causing insecurity of life and property it added to investment risks. The recent developments in Hyderabad will, however, have some healthy effects.

The other factor responsible for business pessimism is economic uncertainty. This is to a considerable extent due to the difficulties experienced by industries in their day to day working. Owing to labour troubles a considerable number of working days was lost. Transport difficulties resulted in insufficient and irregular supplies of coal and raw materials. Capital equipment for replacing outworn machinery is not available. It is also difficult for producers to make reasonable estimates of production costs in view of the inflationary situation. The cumulative effect of all these factors has been a steady decline in output and a steady rise in working costs both of which have resulted in reduced profit margins and dividends to shareholders. The introduction of the Business Profits Tax in March 1947, one year after the removal of the E.P.T., is also known to have affected business psychology because it came at a time when profit expectations were being revised downwards. Lower profit expectations and the difficulty of starting any new ventures have reduced investment activity to a low level. Thus, while 1,614 applications were made to the Controller of Capital Issues to obtain sanction for Rs. 484 crores worth of new issues between October 1945 and March 1947, only 541 applications involving Rs. 193 crores were made between April 1947 and March 1948. Even if we make allowance for the fact that the earlier

period is 1½ times as long as the latter, we cannot escape the conclusion that the desire to float new companies had considerably decreased. It must also be remembered that the figures relating to the control of capital issues do not indicate the capital actually invested in productive activity.

Although the National Government was originally expected to encourage industrial development of the country, the policies followed by the Government of India and the Provincial Governments have been blamed for the present stalemate in industrial progress. Frequent and unco-ordinated statements made by responsible leaders in high position regarding nationalisation of industries, limitation of dividends and other matters relating to industrial policy have, it is said, created uncertainty in the mind of investors as to the future position of private enterprise in India. Very often these statements are pious platitudes and impracticable propositions having no regard to economic realities, and are often meant to appease one sectional interest or another. But coming, as they do, from persons in authority, they have adverse repercussions on business confidence. The Economic Report of the A.-I.C.C. caused considerable stir. The Government of India's Resolution on Industrial Policy adopted by the Indian Parliament on 8th April 1948 made an attempt to set at rest the uncertainty regarding nationalisation, but this document contains important conditional clauses, which appear to the businessmen more or less to defeat its main purpose. The capitalists who work on the basis of profit motive naturally lose the necessary incentive when they believe that the very basis of their effort is attacked. They are conscious of the fact that the Central and Provincial Governments are not in a position to take over industries or to start new ones immediately on a large scale. The Governments themselves seem to be fully aware of the difficulties of entering the industrial field at the present juncture with any measure of success, because of the want of necessary personnel, organisation, skill, finance and machinery. In view of this, there is no other alternative for them, but to

deal with the capitalists in a manner by which they may be induced to continue to produce more and help in sustaining the economy of the country at an adequate level. Unless the National Government is ready to introduce a radical change in the economic structure by taking over industrial production, it is not in the immediate interests of the country to continue to upset those who control production. The forging of ideal economic policies is bound to take some time.

II. FOOD PRODUCTION

Food production in India did not satisfy the minimum nutritional requirements of the population even in the pre-war period. During the war, the chronic deficit gave way to an acute famine in some parts of the country. It was hoped that, with the end of the war, the food situation would considerably ease on account of the cessation of demand for foodstuffs for Allied troops stationed in India and as a result of the increased shipping space which would be available for the import of foodgrains. Unfortunately, however, the food situation worsened in the post-war period, and even though three years have passed since the end of the war the outlook is not brighter today. Although no famine, like the Bengal famine of 1943, has occurred, the situation is in some respects even worse than during the war, inasmuch as food prices stand at a much higher level now than at any time during the war. We shall now consider the main factors responsible for the serious food situation in India.

Although food statistics in India cannot be regarded as very reliable owing to the faulty system of their collection, the table on the following page will give a rough indication of food production during the last decade. The production of rice, which was below the pre-war average during the early years of the war, increased considerably during war years, and in 1946-47 it was 28.1 million tons, being 2.5 million tons below that of the peak year. Wheat production which reached the peak level

of 11 million tons in 1942-43 shows a continuous decline thereafter, being 3.2 million tons below the peak in 1946-47. The total production of foodgrains in 1945-46 was about 1 million tons below the pre-war average and about 6 million tons below the peak level. The Grow More Food Campaign conducted during the war and in the postwar period does not seem to have yielded tangible results, nor have we achieved much so far as improved methods of cultivation are concerned. Multi-purpose river valley projects are estimated to increase total area under cultivation by 27 million acres within 10 years. These projects, however, will not result in an immediate increase in food production.

Production of Foodgrains in India *
(in million tons)

Year	Rice	Wheat	Other food grains	Total
1936-39 (annual average)	26.5	10.3	18.5	55.3
1939-40	25.7	10.8	18.5	54.8
1940-41	22.1	10.0	19.9	52.0
1941-42	25.3	9.0	19.5	53.8
1942-43	24.8	11.0	21.3	57.1
1943-44	30.6	10.8	19.1	60.5
1944-45	28.2	10.6	21.1	59.9
1945-46	26.7	9.0	18.5	54.2
1946-47 (final forecast)	28.1	7.8	n.a.†	n.a.†

Transport Difficulties

The scarcity of food production is unevenly distributed over the entire country. Some areas, like the Bijapur

* "Estimates of Area and Yield of Principal Crops" issued by the Directorate of Economics and Statistics, Ministry of Agriculture, Government of India.

† Not available.

district in Bombay and some parts of Madras Province, are proverbially scarcity areas. Weather conditions have varied effects on the crop position in different parts of the country. In these circumstances, the extent to which local scarcity can be relieved depends mainly on the transport situation. We have seen the unsatisfactory nature of the transport position while dealing with industrial production. We also find that the transport bottleneck has affected the movement of food supplies. This has aggravated the food scarcity in deficit areas, where food prices have spiralled upwards.

Food Imports

It was hoped that with the end of the war considerable food imports would flow in as a result of increased shipping facilities. But it was not possible to wipe off entirely our estimated annual deficit of 5 million tons by means of food imports from abroad, owing to three main factors. In the first place, the destruction of resources and dislocation of productive activity during the war had reduced food production in Europe and South East Asia and the world food situation was serious. Secondly, the inflationary conditions prevailing in most countries increased the effective demands for foodstuffs whose supply was more or less inelastic, resulting in a steep rise in food prices. Food imports from abroad are, therefore, very expensive. Thirdly, India's foreign exchange resources being very limited, these expensive imports have created a heavy strain on them. India had to spend Rs. 24 crores in 1945-46, Rs. 89 crores in 1946-47 and Rs. 110 crores in 1947-48 on food imports.

Increase in Population

The recent fall in food production and food supplies is all the more serious in view of the increase in population during the last decade, which necessitated an increase in food production to maintain even the meagre pre-war diet. Since population statistics for Pakistan are not available

after 1941, we shall give the increase in the population in the Indian Union only. According to the census report the total population in the Indian Union was 298 millions in 1941. According to a recent statements made the Hon'ble Sardar Vallabhbhai Patel in the Constituent Assembly the population in the Indian Union is estimated, on the basis of excess of births over deaths, to be 337 millions in 1948. This increase of 13% during these seven years, therefore, indicates a corresponding decrease in the *per capita* food production.

Increased Monetary Demand

The currency expansion during the war increased the demand for commodities, resulting in a steep rise in their prices. Food prices rose more steeply than other prices in view of the chronic food shortage and the inelasticity of agricultural output. The utilisation of idle monetary resources for consumption purposes in the post-war period further aggravated the situation. The increase in food prices has not led to any increase in food production but, on the contrary, it has led to the marketing of a smaller portion of the output. Since the rents and land revenue payments have remained more or less stable, the farmers can meet these constant costs by selling a smaller proportion of the output at the prevailing high prices. Additional incomes have also been utilised by them for the repayment of debts. After meeting these commitments the farmers do not have enough incentive to market their surplus grain, in view of the acute scarcity of consumption goods, implements and livestock which they want in exchange. In consequence, they prefer to retain more food for their own consumption and to improve their meagre diet. As a result of this, there has been a net increase in the consumption of foodgrains, without a corresponding increase in the available supply in the market.

Adverse Effects of Partition

So far we have not taken into account the effect of the

partition of India on its food situation. Although East Bengal is a deficit area, Pakistan as a whole mainly comprises areas which are surplus in respect of food production. Pakistan's superiority in this respect over the Indian Union is particularly atributable to the location of major irigation projects in Sind and West Punjab. Thus, though Pakistan has only 13% of the total cultivated area of Undivided India, its share in irrigated area is as large as 28%. In 1945-46 the production of fodgrains in areas now comprising Indian Union and Pakistan was as follows:—

Food Production in Indian Union & Pakistan
1945-46 (Million tons)

	Rice	Wheat	Other food grains	Total
Indian Union (including Hyderabad)	18.5	5.9	16.6	41.0
Pakistan	8.2	3.1	2.0	13.3
Total:	26.7	9.0	18.6	54.3
Proportion of Pakistan to total.	30.7%	34.4%	10.8%	24.5%

Although the share of Pakistan in the total population of Undivided India was about 19.5%, its share in the production of all fodgrains was 24.5% and in that of wheat high as 34.4%. As a result, the food deficit in the Indian Union is much worse than that of India as a whole before the partition. Other things being equal, this means a higher level of food prices in the Indian Union than in Pakistan.

In addition to this long-term effect of the partition on the food situation of the country, the wide spread disturbances which preceded and followed in the wake of the partition had a temporary adverse effect on the pro-

duction of fodgrains in the Punjab. These disturbances resulted in the wholesale uprooting of the rural population in the Punjab and created insecurity of life and property; in consequence, agricultural operations and the movement of crops were hindered.

Removal of Controls and Rationing

In view of the gravity of the food situation indicated in the above review, it was imperative to continue with the even distribution of the scarce food supply. The policy of "Decontrol" adopted by the Government of India in December 1947 was therefore most ill-advised and fraught with dangerous consequences. We shall examine in detail the evolution and the results of the policy in the following chapter.

CHAPTER III

CONTROLS *

Need for Controls

It would be appropriate at the outset to compare the working of the price mechanism under normal and abnormal conditions. The normal price of a commodity is one that is determined by the ordinary forces of demand and supply. The price, in other words, would rise when the supply is small as compared with the effective demand at the prevalent price, and fall when the supply is high as compared with such demand. Under a state of affairs when essential commodities are in scarce supply in a given country and the amount of currency in circulation increases rapidly, as during wartime, the normal price, as defined above, is bound to be too high and would result in inflation. Inflationary conditions are an unfortunate evil which usually accompany war conditions, and persist at least for some time during the immediate post-war period. History records the havoc caused by inflationary conditions in various countries, where large numbers of people have suddenly found themselves pauperised, for no fault of their own. It is because the countries of the world have realised the evil of inflation and the havoc it causes to the poorer sections of the people, that they have devised anti-inflationary measures. In the case of essential commodities like food and cloth, anti-inflationary measures take the form of

* The material used in my article on Food and other Controls contributed to the Annual Number of the Commerce in December 1947, has been freely used here, with necessary changes and additions. It may be mentioned that the forecasts of a raise in prices consequent on the decontrol policy then adopted have come true.

State control, both with regard to supply and price, and distribution in the form of rationing by State machinery. If this is done successfully, it will ensure that the scarce supplies are equitably distributed at a price which the people can afford. In other words, the evil effects of inflation are thus greatly mitigated in their operation on the family budgets of large masses of the people.

The control price is, therefore, an artificial price lower than the normal price and enforced by the State by means of its system of controls. The State will be in a position to enforce this lower price, if it is able to regulate demand so as to prevent it from pressing on the supplies. To do this successfully it must be able to control the channels of distribution. Having obtained the available supply of a given commodity, it lays down the maximum quantity of that commodity which each person shall get. The forces of demand and supply are thus made inoperative by control, and the State is thus in a position to enforce a lower price in the interests of the people at large.

Need for Public Co-operation

It is true that such a system of controls has greater chances of success, if all sections of the community, producers, traders and consumers, co-operate with it and help in making it a success. The successful working of such a system also depends to a large degree on the efficiency and integrity of the administrators. There are bound to be in each country some people who will not only resist the enforcement of control prices under such conditions, but will also try to defeat the intentions of the law and obtain for themselves advantages or profits which are possible under such conditions. Under a system of control and rationing, there is bound to be some unsatisfied demand. The richer classes in society are used to more of certain good things of life and can afford to pay for them even at considerably higher prices. So long as such buyers exist, the trader, who is willing to resort to means by which he can obtain stocks of goods, which would under the control

really belong to the administration, finds himself in a position to make large gains. The price at which a trader sells such stocks to such buyers is known as the black market price. The black market price is thus obviously higher than the normal price which would be in operation if there were no controls. It is higher because the trader is, in this instance, anxious to cover himself against the risk which he takes by resorting to a practice which is illegal, namely of obtaining goods by underhand or undesirable means and selling them also secretly. The buyer, if he is so minded, is willing to pay such a high price, partly because he has himself made gains by unscrupulous methods and does not mind parting with large amounts of money for his personal needs in spite of the law.

War-time Controls

The war-time diversion of the country's resources for defence purposes led to an acute scarcity of various consumers' goods and articles essential for manufacturing purposes. This problem was further aggravated by large scale currency expansion, as a result of which prices went on rising continuously to such an extent that the poorer sections of the community could not afford to purchase the goods required to maintain their standard of living, which was already low. It was, therefore, obligatory on the Government to take measures to control prices and to ensure equitable distribution of scarce supplies. Governments in advanced countries like the U.K. and the U.S.A. introduced effective controls in the early stages of the war, but in India the Government did very little to alleviate the distress caused by rising prices. Although a number of controls were in existence before 1943, comprehensive measures were taken only in that year and an elaborate control machinery was built up. The effectiveness of many controls was, however, reduced because of administrative defects and the prevalence of corruption and blackmarketing on a large scale, as a result of a general lack of civic sense and desire to co-operate with the control machinery. In spite

of these deficiencies, the control measures succeeded in curbing the inflation to a considerable extent. This has been proved by the rise in the price level during this year since the adoption of the decontrol policy.

Post-war Policy

After the termination of the war the Government attempted to decontrol less essential articles as soon as possible, and more than a hundred minor controls were soon dispensed with. The first major step was taken early in 1946 when the control over the distribution of steel was removed, but it had to be soon reimposed. When the Defence of India Rules, under which the war time controls were imposed, terminated on 30th September 1946, a number of minor controls were allowed to lapse, but price controls on foodstuffs and other essential commodities were continued through emergency legislation.

In February 1946, the Commodity Prices Board was appointed to advise the Government of India in regard to the formulation and administration of a consistent price control policy. The Board recommended the continuation of controls over foodstuffs and other necessities and over agricultural and industrial raw materials. The Board was of the opinion that decontrol was not likely to increase the available supply of commodities but, on the contrary, it was likely to raise prices owing to the inelasticity of output.

The Government, however, was more in favour of a decontrol policy because of the administrative difficulties which it encountered and also because it felt that prices would fall, after an initial rise, to reasonable levels, once the obstacles to the normal working of the price mechanism were removed. During 1946-47 oil and oilseeds, jute and cotton, copra and cocoanut, tea and shellac, were decontrolled. In a few cases where the demand was not considerably in excess of the supply, prices fell after an initial rise. But in respect of most of the decontrolled commodities, prices went on rising steadily, particularly after the partition, as will be seen from the index number of agricultural

commodity prices:—

Economic Adviser's Index Number of Wholesale Prices of Agricultural Commodities.
(Base: year ended August 1939 = 100)

Month	Year		Index Number	previous figure. Increase over
August	1945	....	268	—
,,	1946	....	304	+ 36
,,	1947	....	352	+ 48
,,	1948	....	444	+ 92

Food Control and Rationing

In the previous chapter we have examined the unsatisfactory position regarding food production and food supplies. During the war the Central and Provincial Governments were at first tardy in taking steps to evolve an equitable distribution of food supplies. Partial controls were instituted in the early stages of the war, but the prices fixed by the Government remained on paper, as control prices could not be made operative unless the Government also controlled distribution and regulated demand. A little later, the experiment of licensing shops for retail distribution and the institution of cheap grain shops was adopted. This naturally resulted in long queues of unsatisfied purchasers at these shops. The effort at partial control and distribution by licensing proved ineffective. Each Provincial Government followed its own food policy to suit its convenience. Consequently, deficit Provinces suffered considerably.

By the time the war ended, however, rationing had been extended to most towns, mainly as a result of the recommendation of the Woodhead Famine Enquiry Commission. Compulsory procurement and rationing were extended even to surplus Provinces, which had hitherto refused to fall in line. But the extension of rationing to cover more and more persons also meant that the Government

had to procure larger and larger quantities of food supplies to maintain the rationing system. But as a result of inability to procure the requisite quantity internally and to secure adequate imports from abroad, a 25% cut in cereal rationing was imposed in February 1946 and the export of foodgrains was entirely prohibited. Further drastic cuts were made in the ration quantum in 1946. In consequence of these cuts the quantity of rations supplied at the end of 1946 was only half as much as that supplied in 1945 and in some Provinces, like Madras, it was only one-third. In 1947 the situation further worsened as a result of further decline in procurement and import of foodgrains. In August 1947 another cut was made in the rations which were already on a meagre scale. As a result of the partition, two important surplus provinces went to Pakistan and the food deficit of the Indian Union increased to that extent. Owing to the extension of rationing even to rural areas, the rationing system at this time covered nearly 40% of the total population. Because of the continuous difficulties which th the Provincial Governments experienced as regards procurement, they were not able to fulfil their enlarged commitments. They were therefore unwilling to continue the rationing system.

In September 1947 the Foodgrain Policy Committee was appointed to make recommendations to the Government regarding the future policy to be followed in respect of food controls and rationing. Though opinion within the Committee was sharply divided, a majority of the Committee recommended a policy of progressive decontrol, which involved the following measures:—

(a) complete decontrol of cereals with the exception of rice, wheat, maize and millets and all pulses except gram;
(b) gradual curtailment of Provincial commitments in respect of distribution and rationing;
(c) a small increase in procurement price;
(d) termination of reliance on food imports.

The recommendations of the Foodgrains Policy Com-

mittee and the Resolution of the A.I.C.C. recommending the adoption of decontrol were received with mixed feelings in various quarters. One section of opinion felt that the controls brought into the public life of the country corruption, bribery and mal-administration, and the only way to remove these evils was to remove the root cause, namely, the control system. This school of thought, led by Mahatma Gandhi, naturally assumed a high moral code, and, from the point of view of moral behaviour, came to the conclusion that the control system must be abolished. They felt that with the abolition of control the masses would be able to get essential goods at reasonable prices. It was assumed by them that large quantities of essential goods were hoarded or were in the black market, and that in the aggregate, these quantities would be sufficient for the requirements of the people at large, once they were allowed to move freely into the market. Hence, they believed that the free market prices of such essential goods would not press unduly on the public and would be within the reach of the poorer sections of the people. They recognised that there might be a temporary abnormal rise in prices, consequent on the lifting of controls, but once things settled down, prices would come down. In any case the rise in prices would lead to greater production and thus defeat itself. It was realised that even such a temporary abnormal rise in prices might lead to considerable difficulties. An appeal was, therefore, made to the business community by Gandhiji to rise to the occasion and belie the prevalent criticism regarding them, by trying to see that the available products were equitably distributed at reasonable prices.

Those, on the other hand, who advocated the continuation of controls did so because they thought that the essential commodities like food and cloth were in scarce supply. So long as this scarcity continued, allowing a free market in these goods would mean higher prices not within the reach of the people. Controls and rationing were the only remedies to ensure that the scarce essential commo-

dities were equitably distributed to the people, irrespective of their economic status. They granted that the deficit as estimated by Government was somewhat exaggerated, because under controls, producers were interested in concealing as much production as possible. The question was whether the concealed stocks were so large as to wipe out the entire deficit. It was also accepted by this school of thought that the administrative machinery was imperfect, that here was a lot of corruption and black marketing and that the statistical data needed considerable improvement. They argued, however, that a great deal of effort had been utilised in recent years and a system of administration had been gradually evolved by means of which it was possible to assure to the poorer sections of the people certain defined quantities of food and cloth at fixed prices within their reach. They believed that the controls should be lifted only when the economic need for them disappeared, that is, when the production of these goods was sufficiently large to ensure a reasonably low price at which all people could buy the goods they required and when the transport system became normal. So long as as such increased production was not brought about and the scarcity continued in one form or another, the lifting of the controls would only result in raising the prices as compared with the controlled prices. And such higher prices would create difficulties to the masses of the people who would not be in a position to obtain their essential requirements at the increased price.

Controls in the Reverse Gear

The attitude of the Foodgrains Policy Committee in this matter may be described as midway between the decontrol school and the control school. The Committee were for the existence of controls but in a largely relaxed form so that the lifting of controls at a later date might become easy. Reducion in the scales of Government procurement and a decrease in the area of rationing, however, were not likely to succeed in achieving any positive results. Our ex-

perience of the development of controls before the institution of rationing shows that efforts at partial control and distribution by licensing shops is ineffective. The recommendations of the Foodgrains Policy Committee meant the institution of partial controls in foodstuffs for some time, before they were completely abolished. That was, in many respects, similar to the ineffective partial controls in foodstuffs which were in existence during the earlier period of the war.

Progressive Decontrol

Despite considerable public opposition, the Government of India accepted the recommendations of the Foodgrains Policy Committee. The Food Minister announced the revised food policy on 10th December 1947. His statement showed awareness of the difficulties and the risks involved in the adoption of the new policy of progressive decontrol. The principle of control in conditions of scarce supply was not refuted, nor was an assurance given regarding the availability of adequate supplies in the immediate future. The new policy was adopted mainly because the system of rationing food had failed and was on the brink of a breakdown. This was so because of the difficulty of obtaining adequate supplies from the grower or by imports; in other words, because the producer did not co-operate with the control system to the desired extent. The success of the new policy was based more on faith than on argument; faith in the wisdom of the individual decision of producers, traders and consumers. Whether the uncoordinated decisions of millions of people would succeed in assuring food to the people at reasonable prices, when the organised wisdom of the administration had failed for want of adequate popular support, has been proved by later events. That there were doubts even in the minds of the authors of the policy regarding its success, is shown by the fact that the control machinery was partly retained and that the policy was to be reviewed from time to time and strict control re-introduced in case this policy failed.

With the adoption of the policy of progressive decontrol, rationing was withdrawn by stages from villages and towns. Only in important cities, like Bombay, rationing was continued. As a result of the removal of price control and rationing, food prices increased tremendously as will be clear from the following index number of food prices:—

Economic Adviser's Index Number of
wholesale prices of Food Articles.
(Base: Year ended Aug. 1939 = 100)

			Net increase over previous figure.
Pre-decontrol:			
December	1947	321	
Post-decontrol:			
March	1948	347	+ 26
June	1948	377	+ 30
August	1948	398	+ 21

This rise in food prices has proved beyond doubt the fallacy inherent in the arguments of the advocates of decontrol. The spiralling of food prices has also been responsible for the acute inflationary conditions we are now experiencing. The expectation that increased food supplies would be forthcoming was completely falsified. Attempts were made to open cheap grain shops but these did not solve the problem. The consultative committees, consisting of economists and representatives of labour and capital, called upon to advise the Government of India in regard to anti-inflationary measures, unanimously recommended the reimposition of controls on food, cloth and other necessities and the Government of India had now accepted this policy. The wheel has now turned a full circle; from partial controls during early war years, we moved towards an elaborate control and rationing machinery during the latter part of the war. As a result of the adoption of the ill-advised decontrol policy this machinery was

dismantled and prices were allowed to rise. It will consequently be more difficult to reassemble its scattered parts and bring down prices back to reasonable levels.

Cloth Control

As a result of heavy military demand for cloth during the war, cloth prices soared very high. In spite of this the production and distribution of cloth remained more or less uncontrolled until 1943. In June 1945, the Textile Industry (Control of Production) order was issued with a view to the standardisation of cloth production. Cloth rationing was also introduced in the same month in important cities like Bombay, Delhi and Calcutta, licensed dealers alone being entitled to sell mill cloth which was acquired by the Government for sale through them. Although the rationing system to a considerable extent succeeded in distributing the available supply equitably, its working gradually deteriorated as a result of administrative difficulties and considerable evasion of control orders by producers and retailers.

We have seen before that in December 1947 the Government of India adopted the policy of decontrol in respect of foodgrains in the hope that more supplies would thereby come into the market. Similarly it was also believed that decontrol of cloth would result in an increased availability of cloth. In January 1948, therefore, the policy of partial decontrol of cloth was undertaken; cloth rationing was discontinued, though stamping of ex-mill and retail prices and control of movements were still in operation. When the Government embarked upon this policy it expected the textile industry to fix 'fair' prices and make cloth available to consumers at these prices. These expectations, however, remained unfulfilled and prices went on rising. After the removal of rationing, cloth was actually sold at prices very much above the stamped prices and enormous profits were made by the industry and trade. In view of the fact that the stamped prices could not be enforced in the absence of rationing and only encouraged large scale

tax evasion, the Government of India decided in April 1948 to do away with price stamping although the stamping of the date was to continue, as also controls over cloth movements. The effect of this decision was to give a free hand to cloth producers and dealers, because the consumers ceased to have any indication whatsoever of thec ontrolled prices. Mill-owners and retailers immediately raised prices by 50% and more. The Government sought to prevent the steep rise in prices by opening fair price shops, but this effort did not succeed because the Government had no stocks of its own to sell to the public. Late in August 1948, the Government decided to reimpose control over raw cotton and cloth. Cloth stocks with mills were frozen and retailers asked to sell their stocks by a given date. The Government has also decided to impose further rigid control measures as soon as possible.

The above review of cloth control policy shows that it has been vacillating and unsystematic. Thus, although there was decontrol, inter-provincial movements were restricted, as a result of which provinces deficient in cloth suffered considerably. The administrative machinery for cloth control had been pratially disbanded and it will take time to set it again in working order. Cloth producers and dealers got plenty of opportunity to profiteer and hoard during the decontrol period. This will reduce the supply of cloth available to the Government for the purpose of distribution and also put difficulties in the way of bringing down the level of cloth prices again.

Lessons of Decontrol of Food and Cloth

The above analysis shows that the essential principle of control, namely that it is desirable to have rationing with a fixed price of essential commodities in scarce supply, is confused with the overgrowth of administrative inefficiency, corruption and black marketing. No one denies that these evils exist. The question is whether we shall face them squarely or assume that with the abolition of controls these evils will automatically cease to exist. The country in ge-

neral is probably unanimous in one thing, namely, that the administration of controls in India leaves much to be desired and that they should be purged of the incidental evils which make them less efficacious. But the removal of these evils is one thing and the abandonment of the principle of control under the given set of circumstances is another.

The advocates of decontrol were obviously disgusted by the black market operations in certain essential goods, which they thought were a great social evil and which, according to them, were directly attributable to controls. They perhaps failed to realise that the existence of controls only gave an opportunity to certain greedy classes of people to make profits. The particular attitude which leads to black marketing is the attitude of making personal gains irrespective of national interests. That attitude finds an incidental loophole in the system of controls and does not mind taking advantage of it. It is not necessarily the effect of control, and it will be there even if controls are removed, but only in a different form. Whereas under controls this attitude is illegal, recognised as anti-social and therefore has to operate secretly, under decontrol it can operate in broad daylight and even assume the garb of respectability. It was too credulous to imagine that, once controls were removed, this attitude would correct itself and producers and traders would desist from availing themselves of the market situation. The only result of decontrol has been that even a few law-abiding traders, who desisted from charging more than controlled rates, have joined the throng and tried to exploit the new situation to the full.

If the hoarded stocks of goods which come to the market on decontrol are not large enough, then prices are bound to rise, because it would not be human to expect that merchants, trading under a free system of capitalistic economy, will deliberately sell their goods at a lower price when the demand for them is heavy and is backed by large purchasing power, though in the hands of a few. Decontrol has only meant giving full play to the operation of the

forces of demand and supply, which were suppressed by the system of controls, and the forces of demand and supply resulted in a price much higher than the controlled price of goods. Any hope that the producers and merchants would pay regard to the interests of consumers, or even to their own long term interests, was bound to be a profound illusion. The entire past record, more particularly during the decontrol period, of this class in India belies any such hope. Scarcely had the decontrol of sugar been announced, a responsible semi-government body like the Indian Sugar Syndicate Ltd. raised sugar prices from Rs. 21 to Rs. 35 per maund. Decontrol has, therefore, merely reduced the number of legal offences, but it has certainly not raised the morals of the business class, for whether prices are controlled or not, charging more than just prices remains unethical, anti-social and immoral.

If the advocates of decontrol were able to show that the supplies were, or were likely to be more, abundant in the near future, then the case for controls would have automatically ceased. So long as these remained mere assumptions, they were wanting us to experiment on the economic and moral planes. On the economic plane the experiment has resulted in higher prices for the masses and inability to obtain supplies and therefore serious malnutrition, if not famine. On the moral plane the experiment has removed the opportunity to make illegal gains. But the very peple who made such gains when there were controls are now in a position to buy out stocks from the market in the hope of rising prices and use their wits to defeat the purpose of anti-hoarding laws, because if they had no scruples about breaking the laws under the regime of controls, they are also not likely to have scruples under decontrol. The problem is not so much of reforming the morals of the people, but given the moral attitude of the people, whether the Government will so reorganise its system of economic administration as not to allow people to suffer serious difficulties in regard to essentials of life till such time as production is increased.

If the Government had taken adequate steps for increasing the production of essential goods on a nation-wide basis, the question of decontrol would not have caused any difficulties as controls would have been superfluous, in case production was really increased. A Government which is drifting towards a policy of economic planning and nationalisation, at least of some industries, and is anxious to ensure equitable distribution on socialistic lines, cannot fight shy of controls; it has to evolve a proper administrative machinery suited to its economic policy, in which some controls will have to operate.

Import and Export Controls

During the war strict import and export controls were enforced with a view to conserving foreign exchange resources for the purchase of defence requirements. As a result of this policy India was starved of a considerable number of articles for which it had to depend upon foreign countries. In the post-war period the main purpose of import controls was to secure large supplies of essential consumer goods, essential raw materials and machinery. With this end in view of the number of items included in the Open General Licence, which permitted unrestricted imports of goods, was increased in October 1945 and again in January 1946. Imports from dollar area countries were liberalised considerably. Unrestricted imports of a number of articles from Empire countries and of a limited number of goods from other countries were permitted.

The effect of this liberal policy was felt only at the end of 1946. As a result of the great pent-up demand for imported articles, orders were placed by importers for all sorts of goods. There was also a shortage of essential goods even in manufacturing countries. For these two reasons, a major portion of the imports consisted of non-essential and luxury goods. In some cases the imports even exceeded the demand. The limited exchange resources of the country were thus recklessly frittered away.

Export controls during the war were framed mainly

to prevent the export of commodities which were scarce in India and which fetched high prices in some foreign countries. After the war was over, the Government sought to relax export controls; restrictions on more than hundred commodities were removed in November 1945. But exports did not increase owing to increased internal consumption and the restrictions placed on the production of commercial crops in order to increase food production.

The combined result of (1) the large import of non-essential articles, (2) the inability to increase exports and (3) expensive food imports from foreign countries to reduce the food deficit, was a heavy adverse balance of trade as indicated by a fall in the sterling balances. Thus, while during 1945-46 the Reserve Bank made a net purchase of £79 million, in 1946-47 it made net sales of £66 million.

The imports policy was, therefore, reviewed in March 1947 and unrestricted imports of some commodities were stopped. Licenses for non-essential imports were curtailed and licenses for bullion imports, which were proving very attractive, stopped. After a further comprehensive review, a more stringent import policy was enforced in July 1947 under which only food, capital goods and essential raw materials could be freely imported, while other items were restricted and nearly 200 luxury items completely prohibited. As a result of dollar shortage which was keenly felt towards the end of 1947, imports from dollar and other hard currency areas were placed in a separate category and their flow was also restricted.

As regards export policy, the main objectives during this period were to conserve essential raw materials to be exchanged against food imports and to correct the adverse balance of trade by means of an export drive, Export policy was, therefore, further liberalised by removing price and other controls on non-essential and surplus items of export.

While the premature relaxation of import controls immediately after the termination of the war had led to the frittering away of our exchange resources, the excessive tightening of import controls in July 1947 resulted in

the utilisation of only £3 million out of a total of £83 million of sterling balances released by His Majesty's Government during the period July 1947 to June 1948. To counteract the inflationary pressure it was of the utmost importance to import a large amount of consumer goods but the stringent import policy succeeded in shutting them out almost completely. Surprise was expressed in all quarters as to how £80 million of the sterling balances released during the year remained unutilised at a time when it was also claimed that the exchange resources of the country were scarce. The Commerce Minister, the Hon'ble Mr. K. C. Neogy, recently gave the following reasons for this paradoxical situation:—

(1) Owing to lack of experience, export earning were under-estimated;
(2) Six monthly sterling releases necessitated the adoption of an over-cautious import policy;
(3) Stringent control meant the prohibition of all but essential imports of consumers' goods in favour of industrial raw materials and capital goods;
(4) Foreign exchange which was earmarked for capital goods remained unutilised because of difficulty in obtaining these goods in foreign countries and the unwillingness of industrialists in India to undertake considerable plant extension.

As a result of all these factors the Government failed to adopt an anti-inflationary import policy. Because of its unrealistic attitude regarding the possibility of importing capital goods, foreign exchange remained unutilised, when even an import of less essential goods would have eased the supply position and checked the rise in prices. The reversals in the import control policy were responsible for an intermittent flow of goods which resulted in alternate periods of scarcity and plethora of these goods. They had an unsettling influence on import trade activity and on the price-level in general.

The fact that India has ceased to be a debtor country in respect of its international balance of payments

as a result of war-time developments has not been fully appreciated. Otherwise the Government of India not have embarked on an export drive which is really suited to a country like the United Kingdom, which has a huge adverse balance of payments and which primarily depends on foreign trade. India, on the other hand, should adjust itself to its new position as a creditor country by being prepared to allow an import surplus.

CHAPTER IV

DEFICIT FINANCING

One of the important causes of inflation is expenditure by Government in excess of its receipts from taxes and genuine loans. Such expenditure is known as deficit financing. If such a policy is pursued, it is bound to lead to the issue of more currency, by means of which the expenditure is incurred. Whatever the justification of resorting to this method of financing in war time, it is not desirable to resort to it in peace time unless there are exceptional circumstances to justify the same. In any case, when the country is already in an inflationary state of affairs, deficit financing is bound to aggravate the evil and let loose the forces of inflation in a manner which is bound to lead to economic disaster. The fact that we have as a legacy of the war a high degree of inflation in the country is not disputed, except by those few who prefer to utilise the situation to their own personal advanage. To adopt a policy of deficit financing under such conditions is highly objectionable. We propose to review in brief the more important items of Government finance in order to show that this tendency is already in operation and requires urgent attention.

Defence Expenditure

The most important item of Central expenditure, viz., defence, was expected to decline as soon as the demobilisation plans were carried out after the world war II. These, however, had to be suspended because of unforeseen circumstances. The widespread prevalence of riots before the partition and the mass murders, which followed the partition in the North, created a state of insecurity, which had to be met with the help of the military in various parts of

the country. The police force had also to be strengthened for the same reasons, though the expenditure on this account was borne by the provinces. Soon after this, there began an undeclared war in Kashmir which is growing in magnitude in spite of the UN Commission. Although the Hyderabad problem has now been satisfactorily solved, the deadlock which continued for a year necessitated the strengthening of security measures in the neighbouring areas and the undertaking of preparations for dealing with Hyderabad. The reduction in defence expenditure has therefore been considerably less than expected.

Expenditure on Refugees

The mass migration of refugees which followed the Punjab tragedy has created an unprecedented situation. Millions of persons had to be moved in either direction at short notice and under disturbed conditions. Arrangements had to be made for their temporary settlement in refugee camps, where they had to be fed and clothed, and given the essential requirements of life, before they could be settled in useful occupations. Similar migration started from Sind in fairly large number, because the treatment which the Sind Hindus received made their life impossible in Sind consistently with self-respect. More recently, we haar of exodus of Hindus from East Bengal to West Bengal. All these have necessarily led to the expenditure of large amounts of money by the State. The Government of India spent Rs. 22 crores on refugees between August 1947 and March 1948, and the budget estimates for 1948-49 provide for an expenditure of Rs. 15 crores. The refugees have been distributed all over the country and part of the expenditure hereafter may be met by the Provinces. East Punjab, which has absorbed the greatest number of refugees from Pakistan, is estimated to spend Rs. 7 crores during the current year. A Refugee Rehabilitation Administration has been set up in Delhi to give financial Assistance to those who want to start industrial and other work, but do not have the means to do so.

Food Subsidy

The difficulties of obtaining adequate food supplies which we experienced during the war have been intensified by the Partition, as the surplus food areas like the Punjab and Sind have gone to Pakistan. The Punjab has suffered immense temporary losses since agricultural operations had to be suspended for some time because of the tragedy that overtook that part of the country. We have thus been forced to import large quantities of foodgrains from abroad. The recent imports are estimated to cost over Rs. 100 crores a year. The distribution of these supplies does bring back a substantial part of this cost, but it is not always possible for the Government to recover its cost price, including the overhead charges by the sale of these food supplies. In many cases the controlled prices at ration shops or cheap grain shops have to be lower than the cost price to the Government. All these result in a net loss to the Government, which may be considered to be the food subsidy to the needy people under present circumstances. So long as we are not in a position to attain relative self-sufficiency in the matter of food supplies we may have to continue to incur this expenditure on food subsidies, which amounted to Rs. 22½ crores in 1947-48.

Pay Commission Award

The large numbers of people employed by Government both in its departments as well as in its commercial undertakings like railways, posts and telegraphs, have suffered from high prices. Their position was reviewed by the Pay Commission which recommended a revision of the scales of salaries and the grant of dearness allowances at certain rates. The acceptance of these recommendations has meant an additional expenditure of about Rs. 30 crores for the Government of India and Rs. 22½ crores for the railways, mainly to help the low grade staff. Similar additions to the expenditure of Provincial Governments and semi-public institutions like Municipalities have also been

made. Though these persons find that their monthly salary packets are somewhat fatter, they realise that in terms of goods which they want they are not in a better situation. This is so because the recommendations of the Pay Commission could not possibly cover the full extent of the compensation required to restore real income to the pre-war level.

Capital Expenditure

We have already referred to the anti-depression psychology which was characteristic of the policy of the Government of India at the end of World War II and the business community in general. It was though necessary that the huge war time expenditure of the Government of India and the Allied Governments should be replaced by other forms of expenditure in order to keep up the economic activity of the country. This wrong, but unfortunately widely believed idea, gave an impetus to large capital expenditure both in Central and Provincial Governments to counter balance an anticipated fall in war time expenditure. The Government of India asked the Provincial Governments to concentrate on those parts of their post war plans which could be immediately implemented in order to keep up employment. In consequence, large public works schemes were taken in hand.

With the advent of the National Government, this tendency received a further impetus because the national leaders showed anxiety to undertake several long-term schemes and to implement without delay several of their ideas regarding economic and social development. Plans were therefore sanctioned for the Damodar Valley Project, the Hirakud Dam and similar schemes. The advent of the National Government was also followed by various new items of expenditure such as the creation of Embassies in different parts of the world, the starting of a network of scientific laboratories and technical training institutions in different centres as well as various schemes for the development of health services. Besides, in order to enable provinces

to embark upon developmental activities, the Government of India is helping them with grants and advances. Central grants and advances made to Provincial Governments are shown below:—

	1945-46 R.E.	1946-47 R.E.	1947-48* R.E.	1948-49 B.E.
	(in crores of rupees)			
Development Grants	—	25	20	30
Advances to Provinces	3	12	22	38

No doubt these plans may increase national wealth and income in the long run, but at the present time they are more likely to give a further impetus to the inflationary pressure. Large scale government expenditure will increase the demand for raw materials, capital equipment and skilled labour which are already scarce, and will thus raise costs and prices all round. This will on the one hand affect industrial activity and on the other hand make the execution of the development plans difficult. In his budget Speech in March 1948 the Finance Minister admitted that "the progress of expenditure on the development schemes has been somewhat slower than anticipated mainly due to the shortage of material and man-power and the time taken to formulate detailed schemes".

Provincial Expenditure

The Provincial Governments naturally followed the same policy. Some of them speeded up their public works programmes; others undertook large industrial schemes. with the help of Central support. The guaranteeing of capital for the starting of certain industries has been a new development in certain provinces. Industrial housing schemes have been approved in various places. Since provincial revenues are limited, they depend to a very large ex-

* 15th August 1947 to 31st March 1948.

tent on development grants and advances from the Centre, to which reference has been made above. The proposals for the abolition of Zamindari and general reforms of land tenures are another characteristic feature of reforms in the provinces. The large amounts involved for payment of compensation have already raised difficult problems. The compensation is expected to amount to Rs. 12 crores in Madras, Rs. 60 to 80 crores in Bihar and Rs. 100 to 136 crores in U.P. On the whole, therefore, nearly Rs. 200 crores will have to be found in order to compensate the Zamindars. The mode of payment also is an important consideration. If cash payments are made, they are bound to increase the inflationary pressure; on the other hand, payment in the form of bonds will saddle the Governments with interest charges for a number of years. In either case, loans will have to be floated either by the Provinces or the Government of India on their behalf. Unless the market for Government securities improves, the floating of such a large amount of loans may result in a significant rise in the rate of interest.

Revenue Resources

So far as the revenue resources of the Central and Provincial Governments are concerned, the situation is unsatisfactory. The Central Government reduced taxation to the extent of Rs. 32 crores in 1946-47, but in 1947-48 taxation was reimposed to the extent of Rs. 39 crores. Direct taxes on business and on high income earners were reduced in the budget for 1948-49 in order to provide an incentive to private enterprise. But in order to offset the reduction in revenue on this account recourse was had to an increase in indirect taxes. Excise duties on tea, coffee, vegetable ghee, tobacco, cigarettes and matches were raised. Since most of these articles are in common consumption, these duties tend to raise the cost of living. When we take into account the fact that provincial taxes are mostly indirect, the total burden of Central and Provincial taxes on consumers is bound to be great. Any increase in such taxes under the

Revenue and Capital Budgets of the Government of India

	Revenue Account			Capital Account			
Year	Revenue	Expenditure	Surplus or deficit.	Capital outlay	Net borrowing	Surplus or deficit	Grand total Surplus or deficit
1946-47 (R. E.)	336	381	–45	204	47	–157	–202
1947-48* Aug-Mar. (R. E.)	179	185	– 6	117	–13	–130	–136
1948-49 (B. E.)	256	257	– 1	128	46	– 82	– 83

* Figures for 1947-48 and 1948-49 refer only to the Central Government of the Indian Union.

present conditions serves only to raise the prices of the taxed commodities, thus intensifying the inflationary pressure.

So far as the provinces are concerned, the introduction of the policy of prohibition will gradually lead to the extinction of the excise revenue. For the current year, the loss due to prohibition is estimated at about Rs. 20 crores of which the complete Prohibition in Madras accounts for Rs. 17 crores. Land revenue is inelastic and in spite of the fact that incomes from land have risen in recent years because of high prices, steps have not yet been taken to tap this source of revenue. A few additions to taxes have been made in the provinces, particularly sales tax. Some provinces have introduced agricultural income tax, but all provinces have not yet taken advantage of this tax.

Deficit Financing

The total receipts of the Central Provincial Governments have not been adequate to meet their expenditure on revenue and capital accounts. The table on page 51 indicates the extent of the combined deficit on revenue and capital accounts of the Central Government.

Hitherto advance payments of taxes on income were not considered as revenue until assessments were finally made, though these payments were not meant to be refunded. By a change in accounting procedure, the Finance Minister decided to treat them as actual revenue and credited an amount of Rs. 10 crores, lying as advance deposits, to the revenue for 1948-49. This has served to disguise the real budget deficit which in fact, amounts to Rs. 11 crores Besides, the actual deficit is likely to exceed the estimated deficit by nearly Rs. 50 crores as a result of intensified warfare in Kashmir, operations in Hyderabad and the continued inflationary pressure.

To this must be added revenue deficits of the Provincial Governments amounting to Rs. 4 crores in 1947-48 (R. E.) and to Rs. 16 crores according to the budget estimates for 1948-49. During 1948-49 the Provincial Governments have budgeted for a capital expenditure of nearly

Rs. 41 crores, which will be financed mainly from the post-war reconstruction fund built up by them during the war.

Borrowing

The question naturally arises as to how the Governments are financing these huge deficits. Normally deficits are covered by borrowing, but under present abnormal conditions there has been a sharp setback in the borrowing strength of the Government of India. Whereas the British rulers in India succeeded in raising large loans during the war, the National Government has failed in its borrowing programme, mainly due to political uncertainty, business pessimism, and above all, the increasing preference of the public to invest their savings in commodities, bullion, jewellery and property. An idea of the amount of loans raised by Government may be had from the following table:

Net Borrowing by Government of India

Year		(in crores of rupees)
1945-46	......	336
1946-47	......	47
1947-48 (R.E.)	......	—13
1948-49 (B.E.)	......	46

Depletion of Government Balances

In view of the failure of the borrowing programme the Government of India had to draw upon its balances with the Reserve Bank. The consequent depletion of these balances is shown below:

Government of India's Balances with the Reserve Bank

Last day of:	Rs. crores	Net increase over previous figure
June 1946	462	
„ 1947	391	—71
„ 1948*	286	—105

Withdrawal from Reserve Funds

The Provincial Governments have drawn largely on their post-war reconstruction funds. The effect of withdrawal of Government balances is to make idle money active. The effect of the use of reserve funds is also inflationary, since this is done by transferring the securities in which these funds are held to the Issue Department of the Reserve Bank which issues the requisite currency against the same. This process has been examined in the following Chapter.

* Including those of the Government of Pakistan.

CHAPTER V

MONETARY ACTIVITY

Factors Affecting Supply

In Chapter II we examined the nature and extent of the post-war decline in production. Although no one will deny the seriousness of the production problem, the tendency in some quarters to attach an exaggerated importance to this factor and to regard it as the main, if not the sole, cause of post-war inflation has led to complacency regarding the monetary aspect of the situation. It is not realised that even if production had been sustained at the peak level reached during the war, the inflation potential would have been sufficient to generate acute inflationary prsssure.

The fact that there has been a decline in production does not necessarily mean that the total quantity of output available for the satisfaction of civilian requirements has decreased. While the decline in production has been responsible for a reduction in the total supply of available goods, there are other factors which have been responsible for an increase in the supply available as far as the civilian population is concerned. Thus, during the war, although production had considerably increased the civilians were deprived of a considerable amount of supplies because these were acquired by the Government of India and other Allied Governments for military purposes; these have now been diverted again to civilian channels. Similarly, factories which were turning out weapons of war have also been reconverted to peace-time production requirements. Imports of civilian requirements which were reduced to negligible quantities during the war have also risen to a considerable

extent. On the whole, therefore, the decline in production seems to have been offset by the increase in supplies on account of these three factors, and it is not wrong to conclude that the aggregate output available to consumers has not declined but has remained more or less constant.

Factors Affecting Demand

The main cause of postwar inflation is, therefore, not a deficiency of supply but an excess of effective demand. In fact this has been the experience of most of the countries. The United States, for example, has actually recorded a significant increase in production, but that has not prevented the occurrence of inflation in that country, because effective demand has outstripped the increase in available supply. The post-war inflation potential can therefore be ascribed to the combination of two complementary factors: (1) a large volume of pent-up demand and (2) the existence of vast monetary resources to make this pent-up demand effective.

(1) Pent-up Demand

(a) **Increased consumption:** The civilian population had to restrict and postpone consumption during the war because a large part of the output was taken away for military purposes. The termination of the war meant a reduction in the military offtake and an increase in the supply available for civilian consumption. Strict controls and rationing imposed during the war had prevented consumers from freely exercising their demand and they had to go without goods, which they could afford to purchase, simply because these goods were not available. But when the war ended controls were relaxed and gradually removed. The premature relaxation of import controls in 1946 flooded the country with a large quantity of consumers' goods for which there was a very keen demand. In 1948 cloth control as well as food control and rationing were dispensed with. All these factors increased the scope for civilian consumption,

(b) **Increased Business Activity:** Private business activity which was eclipsed by the large-scale governmental activity during the war received a fresh impetus in the post-war period. Regimentation, controls and restrictions imposed on trade and industry in order to divert production from civilian to military channels gave way to an increasing degree of freedom for the private sector. Business activity also increased as a result of increased demand for consumers' goods. The relaxation of controls on foreign trade further increased the need for the movement and financing of imports and exports. At the same time, the post-war economic situation was conducive to large scale speculative activity in the commodity, bullion and securities markets.

(2) Monetary Resources

How was this increased consumption and business activity financed? Since the banks do not lend for consumption purposes, the entire consumption expenditure may be said to have been financed from private resources, viz., current income and past savings. As regards the financing of business activity, in addition to private resources we have to take into account bank credit.

(a) **Utilisation of Idle Savings:** The rise in prices in the war period, as measured by the wholesale price index, was less than the proportionate increase in currency and bank deposits. In other words, the entire income generated during the war period could not be, for reasons seen above, utilised for consumption and business purposes. A part of the income had, therefore, either to be saved or invested in securities, bullion or property. The Government carried on a vigorous savings campaign and also instituted compulsory savings schemes. Joint Stock Companies were required to deposit with the Government a part of the excess profits. During the war a large section of the business community made considerable monetary gains, but were not able to purchase goods partly because of controls and partly because goods were not available. Large amounts of money were hoarded because these gains were

in some cases made in black markets and could not, therefore, be accounted for in regular accounts or income tax returns. It was considered prudent to keep back such gains in the form of gold or silver or cash. The safe deposit vaults in important cities were in large demand during this period for hoarding cash and other assets. After the termination of the war, those who had such monetary reserves were anxious to convert them into goods or utilise them in other ways. They did not realise that goods continued to be scarce even after the war. The Government of India tried to catch the black marketeers by issuing an Ordinance demonetising 1,000-rupee notes. Though this created a stir for some time, it seems that the majority of them escaped and it is not yet known as to what steps have been taken with reference to those whose activities were considered doubtful. Dishoarding, dis-saving and disinvestment thus provided the purchasing power to make the pent-up demand effective.

(b) **Rise in Current Income:** While these factors were responsible for providing purchasing power in excess of current income, the latter itself was increasing as a result of the grant of higher wages, salaries and dearness allowances to industrial workers and government and semi-government employees. These were no doubt justified in view of the rising cost of living. But owing to the high propensity to consume of low income groups, they had the effect of creating an effective demand for those very commodities which were in short supply, thereby raising the prices further and thus aggravating the very evil which the additional moneary rewards were supposed to remove.

(c) **Increase in Credit:** Owing to the substantial profits made by businessmen during the war they could finance a large part of their requirements from their own resources and their dependence on banks was, to that extent, less. While we cannot gauge the increase in expenditure made from private funds, we can get an idea of the increase in expenditure undertaken with the help of bank loans from statistics relating to scheduled banks.

Scheduled Banks — Assets and Liabilities
(in crores of rupees)

	Demand deposits	Time deposits	Total deposits	Advances & bills	4 as percentage of (3)	Cash balances with Reserve Bank as % of (3)
	(1)	(2)	(3)	(4)	(5)	(6)
Sept. 1945	664	254	898	264	30	16.1
,, 1947	699	346	1045	418	40	15.0
June 1948	778	330	1108	467	45	12.7

Between September 1945 and June 1948 demand deposits have risen by 21% and time deposits by 27%, giving an increase of 23% in the total deposits. A more glaring symptom of the greater business demand for credit is an increase of about 80% in the amount of advances and bills discounted during the same period. Consequently, the percentage of advances and bills to total deposits moved up steeply from 30 to 45. Although bank deposits had risen rapidly during the war, there was a reduction in the demand for loans for financing private business activity, as a result of various control measures and the direct payment made by government to military contractors. The banks, therefore, had no other alternative but to invest a large part of their assets in government securities and to let their cash reserves and balances with the Reserve Bank increase. The war time distribution pattern of banking assets has now completely altered, the main feature now being decreased liquidity. The tremendous increase in advances has resulted in a reduction of their investment in government securities and in liquid resources. The proportion of cash and balances with the Reserve Bank thus declined from 16.1% to 12.7%. The increased lending activity of the banks has given a buoyancy to the price structure by

sustaining an increased business demand for goods and services.

Speculative Activity

Owing to the great difficulty in obtaining capital goods, the amount of business expenditure incurred on fixed capital is negligible. Almost the entire expenditure is for trading purposes. Consequently, instead of resulting in an increase in productive capacity or in the production of more goods, it has only led to the acquisition and holding of commodities, bullion and securities. Under normal conditions traders are interested in maximum turn-over and so they stock only the minimum quantity of goods and for the minimum period of time. But rising price expectations induce them to increase their stocks and reduce their sales, because they can gain more by way of appreciation of prices than they can from normal trading margins. Manufacturers also attempt to increase their inventories in order to acquire their requirements at lower prices. For these reasons the average period over which stocks are held has increased considerably, thus creating an increased demand for working capital.

The demand for finance for the purposes of speculative activity on commodity, bullion and stock exchanges has also increased in the post-war period. After the removal of E.P.T. and the inauguration of cheap money drive, speculation on stock exchanges increased by leaps and bounds, forcing up security prices. Bank advances against securities for the purpose of stock speculation assumed such large dimensions that the Reserve Bank had to warn the banks against the dangerous consequences of such a course of action. The continuous fall in security prices after August 1946 reduced the attractiveness of security holding and speculation. The decline in business confidence owing to political and economic uncertainties, which brought about the decline in security prices, at the same time, increased the premium on commodities and bullion. Securities, bullion, commodities and immovable

property represent a range of substitutes for a large section of businessmen. Consequently, they transferred their own funds as well as funds borrowed from banks for purchase of commodities, bullion and property and also for speculation on commodity and bullion markets which continued to present a bullish trend. The impact of an increased flow of money on a declining output of commodities has caused a strong inflationary pressure on their prices.

As a result of the increase in private business activity, the superfluity of funds in the capital and money markets, which characterised the controlled war economy gave way to an acute stringency, particularly in 1946, when a large quantity of imports flooded the country. For the same reason government found it difficult to get adequate response to loan flotations, although political uncertainty and business pessimism were also contributing factors. Interest rates hardened and cheap money policy could be sustained only with the help of open market operations which buoyed up security prices which were otherwise showing signs of sagging.

Political Uncertainty and Partition

The political uncertainty during the last three years arising from rioting, the partition of the country and Kashmir and Hyderabad problems resulted in insecurity of life and property. Under conditions of insecurity people try to convert their assets into cash for emergency purposes. The Punjab tragedy, enacted soon after the partition of the country, resulted in the migration of refugees in lakhs. The refugees required cash for the purposes of evacuation and resettlement. In some parts of the country the richer section of refugees have aggravated the inflation problem by offering unusually high prices for urgently required things. It is natural that large numbers of people who were uprooted from their houses and vocation would take a long time before they could settle down to useful and productive oc-

cupations. Meanwhile monetary activity on their behalf from their own private resources as well as from government funds will continue and lead to further inflation.

Extent of Currency Expansion

The above analysis has shown that even if the monetary authorities had done nothing to worsen the situation, the inflationary pressure on the Indian economy would have been very strong. In view of this, the post-war increase in note circulation is very much like adding fuel to the fire caused by spontaneous combustion. The accumulation of sterling securities, which became the basis of the war time increase in note circulation, ceased in June 1946; so we have to look elsewhere for the method of currency expansion after this date. Before doing that, however, it is necessary to examine the nature and extent of this expansion.

Reserve Bank of India — Issue and Banking Departments

	Notes in circulation	Net increase over previous figure	Notes in Banking Dept.	Total notes issued	Rupee securities. Issue Dept.	Investments. Banking Dept.	Total Security Holdings.
	(in crores of rupees)						
Sept. 1945	1147	– –	15	1162	58	23	81
,, 1946	1198	+51	59	1267	58	16	74
,, 1947	1180	—18	92	1272	58	86	144
June 1948	1330	+150	20	1350	128	53	181

Between September 1945 and June 1948 the note circulation increased by Rs. 183 crores, of which Rs. 150 crores are accounted for by the post-partition period of only nine months. This significant increase cannot be dismissed as merely seasonal because the note circulation stood at Rs. 1,229 crores in June 1947 as compared with

Rs. 1,330 crores in June 1948, a difference of Rs. 100 crores. At the same time the rupee securities in the Issue Department have risen by Rs. 70 crores between September 1945 and June 1948 and the investments in the Banking Department by Rs. 30 crores thus increasing the total holdings of rupee securities by Rs. 100 crores. As the gold reserves have throughout this period remained at Rs. 44 crores and the sterling securities have been constant at Rs. 1,135 crores since June 1946, the proportion of gold and sterling securities to total notes issues has fallen from 93.5% in September 1945 to 87.4% in June 1948. In other words, the additional currency has been issued against rupee securities.

Causes of Currency Expansion

We have seen above that the security holdings of the Reserve Bank increased by Rs. 100 crores between September 1945 and June 1948. This is mainly due to deficit financing and open market operations.

(a) **Deficit Financing:** The explanation of the additional issue of currency against rupee securities is partly to be found in the methods of deficit financing adopted both by the Central and Provincial Governments. We have examined in Chapter IV the more important causes which led to deficit financing, taking revenue and capital accounts together. Unless the Central and Provincial Governments make a determined effort to readjust their plans of expenditure in such a manner that they are within their resources of revenue and genuine loans, the need for drawing on the Reserve Bank by means of an additional issue of currency will continue. At a time when we have such a superfluous amount of currency already in circulation, further additions to the same must lead to a more serious situation. It is not realised in certain quarters that even the use of reserve funds by Provincial Governments leads to such additional currency. The reserves are usually in the form of securities which, when the Government concerned requires funds, are transferred to the Issue Department of

the Reserve Bank which issues more currency against the same. The issue of additional currency against ad hoc rupee securities is fraught with grave dangers because, once the Government gets used to this method of financing, it may find it extremely difficult to retrace its steps. Democratic governments are usually subject to a continuous pressure from various quarters for additional expenditure. In our country the hopes and aspirations raised by the Congress are now sought to be implemented at short notice and this has became an additional factor in the same tendency. It has to be realised by all concerned that this desire to spend without adequate financial resources may prove suicidal, inasmuch as it will create complications and difficulties in the very process of carrying out various schemes of reform which the Governments have at heart and thereby increase the prevailing discontent in the country before any fruits of these reforms are realised. The National Governments have to remember the fact that they have inherited an extremely unbalanced economy from the British Government and that unless they first restore equilibrium in the economy of the country, their efforts at hasty reforms may be doomed to failure.

(b) **Open Market Operations:** Another reason for the issue of additional currency against Government Securities is to be found in open market operations. The Central Bank of a country buys and sells Government securities as a part of its monetary technique. These operations are known as open market operations. Without going into the details or justification of these operations, it may be appropriate to refer to the effects of such operations under the existing conditions. In the interests of the prevailing cheap money policy it has been considered desirable that the current prices of Government securities should be maintained at a certain level. Because of the prevailing tendency in the investment market, Government security prices sometimes show a tendency to fall. On such occasions the Reserve Bank steps into the market and buys securities at a higher rate, thus giving a fillip to the market. As a result

of these transactions the securities pass to the Reserve Bank and in return the Reserve Bank expands the currency with the help of which the security purchases are made.

Also on certain occasions, when Government loans are not fully subscribed, the Reserve Bank takes them over and credits the Government concerned with the necessary funds. It may be able, at a later date, to sell the securities in the market which, however, under the present conditions is doubtful. The effect of this operation is the same as in the case of the expansion of currency against *ad hoc* securities issued by Government from time to time. Both these methods have been responsible in recent times for additions to the currency and a considerable restraint will be required hereafter in pursuing this policy any further. When it is remembered that the nominal surplus budgetted for the year 1948-49 is likely to turn into a huge deficit at the end of the year, the caution given here, i.e. the urgent necessity for reducing expenditure, raising taxation and having balanced budgets, so that the need for deficit financing by the issue of more currency may be avoided, will be appreciated.

CHAPTER VI

EFFECTS OF RISING PRICES *

In connection with the continuous upward tendency of the price level, we should remember that it causes serious harm to the economic life of large numbers of people, who find themselves suddenly reduced to poverty and want. Every rise in price implies that the value of the rupee has fallen to that extent. Thus by now the value of the rupee has already fallen to one-fourth of its pre-war value. If prices still go on rising, the value of the rupee will fall still further. This is bound to create innumerable difficulties in the life of millions of people. Some of the more important of these difficulties are explained below.

Impetus to Hoarding

Inflation leads to hoarding of commodities, including foodstuffs. In view of rising prices, those who can hold on to their stocks do so in the hope of getting a better return. Consumers prefer to buy a large quantities if they can, to avoid having to pay more in future. The hoarding of foodstuffs, during the war before food control was introduced is well known. The recent phenomenal rise in the prices of essential commodities is due to the preference for different commodities which people are showing. It is known that the purchase of certain commodities is in excess of requirements. This tendency causes an artificial scarcity of essential commodities and the poor suffer in consequence. When the situation becomes graver the Government is compelled to make feverish arrangements for price and food control

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* The material published in "Financial Burden of the War on India" by me in 1943 has been freely used in this Chapter with suitable changes.

and to take steps to prevent hoarding. Such measures, however desirable in themselves, become extremely difficult to administer, so long as the cause of trouble, viz., inflation, is not removed.

Effects on Production

It is believed in certain quarters that rising prices give an impetus to production. There is an element of truth in this statement. When the prevailing prices in a country are not sufficiently high to give the necessary impetus to the producer, a small rise in prices might have the desired effect. This does not, however, mean that the rise in prices should be continuous, as such a phenomenon is bound to defeat the purpose. Continuous rise in prices must involve a continuous rise in the cost of production. It also involves considerable uncertainty in making any financial estimates of return on outlay for any productive establishment. There are limits to which prices of certain commodities can go without having adverse effects on demand. At a certain stage, people will refuse to buy unless prices are lowered and this will have an adverse effect on production. If there was any truth in the belief that rising prices helped production, our agricultural and industrial production ought to have now increased considerably since the war, because we have been having the phenomenon of continuously rising prices all these years. On the contrary, it is well known that production has fallen in spite of continuously rising prices. There cannot be any greater proof of the fallacy underlying this belief of high prices being conducive to greater production than the well known facts of the situation in the country amounting to a production crisis which we have described in a previous chapter.

Delusion of Inflationary Prosperity

In times of inflation businessmen and industrialists are able to earn larger money profits. In spite of the fact that they may be taxed higher, the rich are able to grow richer under such conditions. The businessman is, therefore, in a

happy mood; he thinks that the cause of his prosperity is the rise in prices and he feels that such a continuous rise is in his interest. He is not able to see that these are merely paper fortunes, i.e. though he gets more rupee notes, the value of each rupee in terms of goods is less.

Inflation creates and intensifies all the contrasts of wealth and poverty, of abundance and shortage. The apparent prosperity of the few rich may delude them into the belief that all is well, but they will realise in due course that this prosperity is temporary. In any case the prosperity of the few is not the prosperity of the country as a whole and it is to be expected that the delusion caused by this inflationary prosperity will not be a cloak for ignoring the menace of inflation to society in general. It is well known that the business community in this country welcomed the inflation during the war for some time, and have been accustomed to tolerate it inasmuch as it helps them in a variety of ways. The record of the various commercial bodies since the war does not show any determined opposition to the inflationary methods of war financing or of post-war deficit financing. In fact, there is a section of influential businessmen who do not mind preaching views in favour of higher prices, thus misleading the public in general. * The businessmen who were called to advise the Government on the present economic situation in August last hesitated to face the problem squarely. They were more worried about what they called "crisis in confidence" than the need for comprehensive anti-inflationary measures.

Effects on Labour

We have already discussed in Chapter II the economic unrest caused among industrial workers by continuously rising prices, the occurrence of frequent strikes and the consequent loss in production. During the war, businessmen did not mind giving dearness allowances

* Vide Appendix.

and the Government encouraged the same because of the wartime need for production. Businessmen were in a position to earn large profits at that time and preferred to keep the labourers contented, so that they might be in a position to reap the rich harvest of profits. In more recent years, labour has increased its demands and industrial disputes have become more frequent. Though labour has been able to obtain substantial advantages and higher monetary rewards, it has been realised that these rewards are inadequate because of rising prices. Labour leaders have understood that their efforts in getting more for labour are defeated by rising prices. They have, therefore, demanded adequate measures to stop this tendency in the interests of labour.

Whereas this is true of industrial workers, the position of agricultural labourers is not satisfactory because they are not organised. Though agricultural producers, either owners or cultivators, have received a higher monetary return because of higher prices of agricultural commodities, the wages of agricultural labourers have not risen in proportion. Some efforts have been recently made to improve the lot of agricultural workers, though it is difficult to ascertain the exact situation unless and until reliable data are collected.

Effects on Middle Classes *

Though industrial workers get some attention under inflationary conditions to keep them contented, adequate attention is not paid to the plight of the middle classes. The middle classes in this country, as in any other country, are the backbone of society. They are generally educated. As a rule, they are fixed income earners. They work mostly in Government offices or private business offices or in other institutions; their income is usually in fixed salaries.

* This section is based on my article on the subject contributed by me to the Independence Day Number of the "Forum," 15-8-1948.

The leaders of society are usually drawn from this class, some of whom by their capacity and perseverance gradually come to the top in different spheres of life. In democratic countries, as a rule, it would be educated people drawn from the middle classes who obtain support of the electorate as legislators or in other capacities. This means that if a country neglects the middle class instead of developing it into a strong element in society, it is likely to suffer in efficiency and progress.

Because of the continuous inflationary situation in the country now for over five years, the plight of the middle classes has become increasingly deplorable. The average standard of life of a middle class man is higher than that of a working class person. He prefers to live in a manner by which he is easily distinguished from what is known as the working class. If commodities of daily requirements which he needs for maintaining his standard of life go up in prices and his income does not rise in proportion, the only alternative for him is either to live on his savings, if any, or to reduce his standard. As this class of people cannot have large savings, the inevitable consequence is that the continuation of the inflationary situation must impinge upon the existing standard of the middle class, which is none too high. The incomes of this class of people have not increased in proportion to the rise in prices. The quantum of Dearness Allowance given to the middle class in Government and other offices to offset the rise in prices is compartively meagre. In most institutions it takes a long time for the authorties to decide this question. By the time a decision is taken on the basis of a given price level, the price level itself has increased considerably, making the actual dearness allowance somewhat out of date. To illustrate, one can only to turn to the calculations of the Pay Commission in this connection. The Commission made its calculation on the basis of a certain price level which it assumed for its purpose. It suggested adjustments if prices rose from that level. It did not think in terms of off-setting the entire rise in prices by a corresponding dearness

allowance. In spite of this, the expenditure to the Central and Provincial Governments on this account has gone up by crores of rupees. What has happened is that by now, because of the continuous rise in prices some of the recommendations of the Pay Commission, as implemented by the Central and Provincial Governments, have become obsolete. The same is true of semi-Government institutions and private business offices, where people with fixed incomes do not get their due either in sufficient quantity or in reasonable time.

Apart from this obvious disadvantage, there are other factors which add to the difficulty. Because of the existing social structure, as a rule, in middle class families the earners are few and the dependants are many. In most families usually there is one earner, the rest are dependents. In the case of working class families, it is known that there are more than one earner in a majority of cases. In times of rising prices, when the earner is not able to obtain a corresponding rise in his income, the fact that he has to support several dependents causes serious hardships to him. He must either reduce the consumption of essential goods like food and cloth or reduce the nutrition and comfort of his family. The members of such families thus become increasingly inefficient members of society with the inevitable discontent which arises from such a state of affairs. Under such conditions there are temptations to go in for black marketing and other methods of making more gains to make both ends meet.

Another evil from which this class suffers is that the value of their savings, if any, has gone down considerably because of inflation. The savings of this class are in the form of Life Insurance Policies, Provident Funds or Savings Bank Accounts and Cash Certificates and things of that nature. The investments made by them over a long period in these forms for a rainy day have gone down in value because of forces over which they have no control. When the middle class man retires and realises the value of

his policy, he finds that he does not get in real goods the value which he intended to have when he contracted for the policy some years ago. The same remark applies to other forms of investments referred to above. This must in many ways affect the position of the middle classes adversely.

The difficulties of the middle classes must be tackled more effectively than hitherto because, unless sufficient attention is given to their grievances, serious repercussions will take place in the social life of the country. If those in authority realise the serious consequences of allowing the deterioration in the position of the middle class to continue, there might be some chance of some positive action being taken to cry a halt against this tendency before it is too late.

Effects on Government Budgets

Government departments which have to purchase materials and services find it difficult to do so in times of continuously rising prices. They are required to pay more for goods required by them. Demands for higher wages and salaries become insistent from their employees because of higher prices. We have pointed out in a former chapter that as a result of the recommendations of the Pay Commission, the additional expenditure to the Central Government has been about Rs. 30 crores. The same remarks apply to semi-Government institutions like Municipalities, Port Trusts and so on. In consequence these bodies have either to resort to higher taxes or give reduced or less efficient service. There are obvious limits to which taxes could be raised or services could be reduced. Both the processes are likely to create discontent and trouble, because large sections of people are likely to be affected by the actions of these bodies.

Relations Between Creditors and Debtors

In modern times numerous transactions and contracts over short or long periods are made in terms of money.

The nominal value of money invested in such transactions remains the same, but their real value goes down when prices continue to rise. Debtors are in an advantageous position under such conditions because when they pay back, though they are nominally paying their debts, in terms of goods they are really paying a smaller value. But all debtors may not be in the happy position, under such conditions, of obtaining sufficient resources to pay off their outstanding debts. When the family budgets of people get continually upset under conditions of rising prices, the problem of finding sufficient surplus to pay the debt does not arise; the problem often is to incur more debts to carry on.

Conclusion

The disasters caused by inflation, affecting the very basis of modern economic life, from which the peoples of Europe suffered during the first World War led to such fears of inflation that during the second World War European countries and the U.S.A. took timely and drastic steps to control inflation. When we remember the vastly greater magnitude of war operations and, therefore, of war expenditure during the second World War compared with the first, the success of anti-inflationary measures achieved in European countries and in the U.S.A. during the second World War must be characterised as remarkable. During the post-war period, in countries like the U.K. and the U.S.A. there has been a tendency for some rise in prices which, however, is limited compared with the level reached in this country. The authorities in those countries are taking all available steps to control the situation in the interests of society in general, with the co-operation of the people. It is well known that it was the wholesale ruin of German families due to inflation in World War I, that paved the way for the Nazis in the inter-war period. The ruinous extent to which inflation has been carried in China in recent years is well known. It is to be hoped that these danger signals will prove a sufficient warning both to the authorities and the people in this country so that timely

steps may be taken before it is too late. Anti-inflationary measures cannot succeed without the co-operation of the people. The comparative failure of such measures under British rule may be attributed mainly to the apathy or even the hostility of the people to them. It is to be hoped that under the new environment, the people will change their outlook, and appreciate that anti-inflationary measures are in the general interest of society as a whole, and should be faced cheerfully by all.

CHAPTER VII

REMEDIES *

I. FISCAL AND MONETARY

The underlying object of the fiscal measures is that the expenditure of the Central and Provincial Governments both on revenue and capital account should be within the resources of these Governments, i.e. it should not exceed revenue plus genuine loans. In other words, deficit financing or incurring of expenditure which may lead to further inflation must be avoided. Towards this end, suggestions have been made, on the one hand, for the reduction of expenditure and, on the other hand, for increase in taxation, as well as for methods by which more loans could be raised. It is the combined effect of these measures which is important. In doing so some sacrifice will have to be undertaken by different classes of people and the measures should, therefore, be judged from this point of view. In order to avoid a more serious economic crisis, different classes of people in the country should be prepared to undergo some sacrifice, each according to its capacity.

Retrenchment of Expenditure

1. Both in the centre and in the Provinces, there has been a large war time and post-war growth of staff in different departments. In place of the present half-hearted

* It is proposed in this chapter to explain briefly the remedies suggested by Economists who were consulted by the Government of India in the middle of August 1948. The classification and arrangement adopted by the Economists are used as far as possible. The ideas have been explained more fully wherever necessary.

attempts at retrenchment in some of these, a more thorough going examinaion for retrenchment should be undertaken without delay so that a substantial saving can be effected.

2. **Welfare Activities:** The expenditure on schemes of social and educational developments or of a similar nature was hitherto limited on account of the policy of the British Government. The National Government is naturally anxious to go in for schemes by which the welfare of the people could be promoted. Most of the schemes are likely to be desirable in themselves. The question, however, is whether under the present emergency, we can afford these schemes which by causing additional expenditure lead to further inflation. The object of the schemes may thus be defeated. It is, therefore, desirable to review the proposals in such a manner that the expenditure may be limited to current revenues.

3. **Central Grants to Provinces:** Several large amounts of grants have been recently given by the Central Government to different provinces for various schemes of development. At a time when the Central Budget is itself in deficit, the continuation of these grants obviously leads to further inflation. The only exception that could be made is in those cases in which public expenditure is definitely likely to add to the production of essential commodities in the immediate future.

4. Various schemes have been put into operation with a view to increasing production, as for example the Grow More Food Campaign. It is well known, however, that in most of these cases the expenditure is not commensurate with results. It is desirable, therefore, to scrutinise these schemes carefully so that expenditure may be incurred only on those schemes where definite results in the near future can be obtained.

5. **E.P.T. Deposits:** Under the arrangements for the Excess Profits Tax certain deposits have accumulated with Government and are due to be returned during the current and future years. The object of this arrangement was that the industrialists would be in a position to utilise these

amounts for productive purposes, such as imports of machinery. Owing to the prevalent difficulties of obtaining the same, it would be appropriate to postpone the refund of these deposits. Exception, however, should be made in those cases in which refunds would be definitely invested for immediate productive purposes in the near future.

6. **Long-range Schemes:** Various schemes involving capital expenditure have been undertaken or are about to be undertaken. The financial aspects of these schemes have not been carefully considered. Most of these schemes are long range schemes, each of them very desirable in itself and likely to bear fruit in the long run. In the immediate future, however, such expenditure is bound to add to inflation. It is desirable, therefore, that all existing commitments of capital expenditure should be reviewed with the object of ascertaining which could be postponed without any serious disadvantage. For example, those schemes in which work has gone so far ahead that postponement would lead to obvious waste, there is no alternative but to proceed with it. On the other hand, in the case of all those schemes where some delay would not seriously matter, the balance of advantage is in favour of postponing them.

7. **Prohibition Policy:** The Provincial Governments are committed to a policy of Prohibition. This policy, on the one hand, reduces an important source of revenue to provinces and, on the other hand, increases their expenditure in the enforcement of the policy. It is obvious, therefore, that the Prohibition policy aggravates the inflationary tendency. Without going into the question of the desirability of the Prohibition policy, it is obvious that under the present emergency, when nothing should be done which adds to further inflation, the postponement of these schemes is called for.

8. **Abolition of Zamindari:** In several Provinces schemes for the abolition of Zamindari have been undertaken or are about to be undertaken. One of the features of these schemes is compensation on certain scales to the Zamindars. This may lead to further inflation inasmuch

as large amounts of cash will be put into the hands of certain classes of people. If these schemes can be pushed through without injecting additional cash into circulation, i.e. without aggravating the inflationary tendency, there need be no objection to it.

Taxation

1. **Prevention of Tax Evasion:** Before considering proposals for new taxation the Government should see that its machinery for collection of taxes is improved and stringent measures taken to see that evasion of taxes is prevented. That large amounts of taxes have been evaded in recent years is indicated by the appointment of the Income Tax Investigation Commission. Though the Commission has been armed with certain powers, it is well known that it is finding its work rather difficult in view of the fact that certain parties who are in a position to give information, such as banks, do not give the necessary co-operation in its work. At the same time, because of the judicial character of the work of the Commission, it is possible for interested parties to see that the work is delayed as much as possible. It is desirable to make arrangements by which delays can be avoided and the necessary information can be obtained by the Commission. It has been estimated by some that the amount of tax evasion is of the order of 100 crores of rupees and it is obvious that adequate steps are urgently called for to make this machinery successful.

2. **Income-tax Surcharge:** A graduated surcharge on Income-tax on personal incomes above Rs. 5,000 should be considered. This means that there may be room either for a change in the income level suggested or for the introduction of a very low surcharge at the earlier stages so that fixed income groups, who are severely hit under the present circumstances may not be over burdened. It is possible, however, to find out by a detailed examination that some additional income could be raised by this method without delay.

3. **Business Profits Tax:** The Business Profits Tax which now stands at 10% should be increased to 25% Objection has been raised to this suggestion on the ground that this would prove a disincentive to production. No facts, however, have been adduced in support of this contention and there is nothing to show in the recent history of Indian taxation that changes in taxation have had a close connection with productive enterprise. No one denies that if in a given specific case hardship is proved necessary relief may be given. But mere general propaganda against increase in taxes on business profits cannot be taken at its face value, unless convincing proof is produced.

4. **Super-tax:** The rates of personal super-tax which have been reduced during 1948-49 should be raised to the levels which were in operation during 1947-48. At a time when the emergency demands that surplus purchasing power should be mopped up, there can be no justification for leaving the highest incomes untouched.

5. **Estate Duties:** The introduction of steeply graduated death duties without delay is called for. Proposals in this connection have been under consideration for some time. It is imperative that a beginning should be made without delay so that this source of revenue can be tapped as soon as possible.

6. **Agricultural Income-tax:** The introduction of agricultural income-tax in all provinces is desirable. In the case of certain large landholders, incomes from land have risen substantially in recent times because of higher prices. It is appropriate, therefore, that under the present circumstances these parties should be made to contribute their share to the State.

7. **Surcharge on Land Revenue:** On the same argument, those holders of land who pay at present more than Rs. 200 per annum should be asked to pay a graduated surcharge on land revenue. Land revenue is fixed in permanently settled areas and is very low. In the temporarily settled areas, it is fixed for long periods, say for 30 years at a time. These assessments do not take into account the

recent abnormal rise in prices which has led to substantial gains in the rural areas. Such a surchage, therefore, would be justifiable under the present circumstances.

Borrowing

The following measures are suggested to make Government loans more attractive and the borrowing programme more successful.

1. **Treasury Bills:** The issue of Treasury Bills for ways and means purposes is ordinarily restricted to 3 months. It is suggested that if Treasury Bills are issued with a longer duration, viz. 6 months or a year at slightly higher rates of interest than that given for 3 months' Treasury Bills, it would attract investment by institutions such as banks and insurance companies.

2. **Small Savings:** Though the present cheap money policy with its low rate of interest need not be changed, it is possible to attract small savings by a variety of methods. For example, the issue of non-negotiable 3 and 5 year Savings Bonds at a higher rate of interest than that now given on negotiable Bonds of equal duration would attract some funds. Similarly, the issue of National Savings Certificates for 3 and 5 years, in additon to the 12 year Certficates that are now issued, would attract small savings. At the same time, it must be emphasised that all political parties should take part in intensive popular campaigns in support of small savings, so that the people at large may realise the importance of such savings.

3. **Gandhi Memorial Fund:** So far as the collection made for the Gandhi Memorial Fund are concerned, it would be desirable not to incur any significant expenditure from it for the time being. It would be desirable to invest the collections in Government Securities or hold them in deposit with Government. This would mean that the amount thus collected would be temporarily withdrawn from active circulation.

4. **Repayment of Loans:** In the case of terminable government loans, there are usually clauses giving option

to Government to repay the same over a period of years. It would be desirable for Government to postpone the repayment of such loans to the maximum period available under the termination of the loans.

5. **Deferred Bonuses:** It is usual for industrial concerns to give bonuses to their workers in addition to their wages and dearness allowances. It would be appropriate to give such bonuses in the form of Savings Certificates instead of in cash. It may not be possible to do so in the case of the lowest income groups who consider the bonuses as part of their current expenditure. In those cases, however, where the annual income exceeds Rs. 500, it may be possible to apply the above method, subject to the condition that the figure will be varied in the light of local circumstances in different industrial centres.

Monetary Measures

1. **Ceiling on Note Issue:** A ceiling should be put to the total value of notes issued by the Reserve Bank of India. It may be limited to the existing amount. This would prevent the increase in currency backed by *ad hoc* Securities for financing public expenditure. It is possible that there may be some need for elasticity in order to enable the Reserve Bank to meet seasonal currency demands and day to day fluctuations in Government expenditure. A narrow range may be decided within which the Reserve Bank may be permitted to restrict its operations for the necessary increase in currency during such special circumstances. This would, however, be an exception. If the Government implement the measures suggested above which are calculated to bring about balanced budgets both on revenue and capital account such difficulties would not arise.

2. **Credit Restriction:** The minimum holding of Government Securities by banks should be fixed at 25% of the total demand liabilities. The Reserve Bank may be given the power to make exceptions in suitable cases. This would act as a deterrent to the banks so far as the issue of credit

is concerned and would to that extent help Government's borrowing policy.

II. CONTROLS

Economic controls are an essential part of an anti-inflationary campaign and they should be carried out in such manner that the objective is realised.

Ceiling on Personal Incomes

One of the first things which must be done is to put a ceiling on all personal incomes such as wages, salaries and dividends. It is possible to argue that a measure of this nature might lead to inequality in some cases. Those fixed income earners whose salaries have not increased in any proportion with reference to the prevailing high prices and who, in consequence, have been hard hit, are naturally expecting a higher monetary return. It is however an unavoidable feature of an anti-inflationary policy, if it is to be made effective, that a ceiling to all personal incomes be put as suggested above. Whereas such an inequality might be found for some time, as soon as prices are brought under control and perhaps lowered, such inequality would disappear.

Limitation of Dividends: Whereas it is easy to lay down that wages and salaries shall not be increased beyond the existing levels, in the case of dividends, it is necessary to work out a suitable formula. It should be laid down that dividends declared by companies should be limited to the average of the last two years' dividends. In the case of new companies the dividends should not exceed 6%. The limitation of dividends in this manner may result in a larger amount of undistributed profits which should be held as compulsory deposit against Certificates of one or two years' duration.

Rent Control: While limiting these incomes, incomes from house rent should also be controlled. In some centres rent control is in existence. It should be brought into operation where it does not exist.

Price Controls

As soon as Government decides to put a stop to further increases in salaries and wages, it automatically creates an obligation on itself to see that the prices of food grains and other essential commodities do not rise further as compared with their existing levels. It is obvious that if prices of essential commodities go on rising and people are not in a position to obtain such commodities within their existing incomes, the proposal to put a ceiling on salaries and wages cannot be carried out. Government will therefore have to notify ceiling prices for all food grains in both rural and urban areas. So far as the urban and industrial areas are concerned, Government should organise a system of rationing so that the cost of living of industrial workers and other wage and salary earners may be stabilised at reasonable levels. The level should not be much higher than that which was prevalent before the recent rise in food prices. This will mean that the necessary supplies will have to be obtained by Government. Imports of food will have to continue so long as local supplies are inadequate. So far as local supplies are concerned, a compulsory levy should be made on every holding which yields more than 25 maunds. At the same time, Government should purchase grain in the open market. Questions of the prices to be paid to the producer as well as the extent of the subsidy that the Government should give for the sale of food grains will arise. Prices should be as low as practicable. Government may not be able to realise the same price by the sale of grains to the consumers. The difference will have to be realised from the subsidy which Government gives to the consumers. The Government does incur such expenditure on imported food. The same will have to be done with reference to food locally obtained. That subsidy will have to be limited to the current resources of Government obtained mainly from revenues.

It is possible that some of the Provincial Governments,

particularly the deficit provinces, may adopt similar measures for rationing of foodgrains in rural areas also. In case they do so they should observe the following conditions: (1) They should not expect to obtain any additional quotas of grains from the Centre on this account; (2) the prices that they pay to producers in any scheme of monopoly procurement should not be much higher than the prices at which food grains are now sold in ration shops.

As suggested above the prices of other essential commodities should also be controlled. The new system of control of prices and distribution of cotton and cloth which is being introduced should be developed without delay on the lines of a State Monopoly. Similarly, the control of prices of oilseeds, paper, vanaspati, cement, steel, coal etc. should be continued. In the case of sugar, the price should be controlled whereas the distribution should be left to the provinces. Similar steps should be taken for kerosene, petrol and fire-wood. While taking such measures, Government should take adequate steps to prevent hoarding and profiteering.

III. PRODUCTION

Though a substantial increase in production in the short run may be difficult, it is imperative that immediate steps should be taken to organise production and control. Government should, for example, fix a programme of production targets for each major industry and establishment. It should be the duty of those in charge of these industries to carry out these programmes. It is known that there is considerable room for improvement in the internal organisation of industrial establishments, and for increasing their efficiency, leading to greater output. Government should take urgent steps with the help of representative technicians to investigate the position of each industry from this point of view and introduce the necessary measures for greater output. At the same time the Provincial Governments can take more energetic and organised steps to increase the output of small-scale and cottage industries, so

that the shortages of essential goods could be reduced by these means.

At the same time some incentive should be provided for greater industrial production. On the one hand, new companies should be granted some rebate of taxes; on the other, workers may be given production bonus on production over a certain standard output. So far as agricultural production is concerned, the existing efforts made in the Provinces should be intensified without delay so that such production may increase.

While efforts to increase production may be made in this manner, severe controls should be introduced in order that the production may be regulated consistently with the anti-inflationary policy. Towards this end the following controls are suggested.

Control of Capital Issues: The present system of capital issue control should be modified. Capital issues for industrial enterprise should be made as free as possible. Capital issues for financial institutions such as banking companies and investment trusts should, however, be scrutinised with care as now. In the case of those companies where immediate capital equipment is not available, the funds raised by companies should be held in Government Securities pending the availability of capital goods for that purpose. By these means some of the surplus purchasing power in the hands of the people will be mopped up and invested in Government Securities for the time being.

Control of Raw Materials: The existing controls on the allocation of essential materials like steel, cement etc. should be continued. The object of the allocation should be to help in the production of essential consumers' goods for the time being. Even if this involves the postponement for some time of some of the long range schemes of Government, preference should be given to immediate needs.

Control of Imports: The import policy should be liberalised. Essential consumer goods should be given preference. The imports of non-essential goods may be restricted. So far as capital goods are concerned special efforts

should be made for importing them from countries such as Czechoslovakia, Canada, Australia, Japan etc. At the same time, arrangements should be made to obtain larger supplies of kerosene, petrol and other essential commodities.

Control of Exports: The object of export control should be to bargain for essential supplies from other countries either for consumers or producers. For this purpose bilateral trade agreements with other countries should be entered into. It may be done either by a method of state trading or, alternatively, importing countries may be given facilities to buy and export from the country the commodities to which they are entitled under the bilateral agreements. Essential supplies thus obtained from other countries should be allocated to industry by Government. The object in doing so should be to increase production of essential commodities in the immediate future. In the same manner essential consumers' goods obtained from other countries as a result of such agreements should be equitably distributed.

Machinery for Co-ordination

It is obvious that anti-inflationary measures affect economic life in most spheres. In some of these spheres the Central Government will have to interfere; in others the Provincial Governments will have to do so in order that the policy may be carried out. Unless the different Departments of the Central Government and the Governments of Provinces, Unions and States decided to march in step and bring about a complete co-ordination in implementing these measures towards the common objective of preventing and reducing inflation, the policy cannot succeed. It is desirable, therefore, that an adequate co-ordinating machinery should be instituted without delay to bring about the desired results.

Organic Unity of the Scheme

Such co-ordination is all the more necessary because of the need to preserve the organic unity of the scheme

of anti-inflationary measures suggested above. It is obvious that these measures are inter-related and cannot be taken in isolation. They are all calculated to serve the common objective of preventing and reducing inflation. There is a tendency to pick and choose and adopt some of the suggestions, ignoring others. It is possible to criticise one or more of these suggestions from the political moral or other points of vew. If, however, the scheme as a whole is taken into account it will be realised that it is calculated to restore economic health to the country and would thus be a sounder basis for carrying out all those schemes of political, moral and cultural reform which are desired, but which would be impracticable in the absence of an economic equilibrium in the country.

CHAPTER VIII

ANTI-INFLATION POLICY OF THE GOVERNMENT OF INDIA

Broad Considerations

The statement of policy issued by the Government of India on 4th October enunciates in the first place certain broad considerations which are the bases of that policy. They are: (1) "To take all possible steps to keep the Government expenditure as low as possible consistent with efficiency and to increase revenue by all available means;" (2) "to make a concerted effort immediately to ensure that there is no further rise in prices and the cost of living;" (3) "to order future policy so as to secure in the shortest possible time progressive reduction in prices to reasonable levels and the supply of an increasing volume of goods and services;" and (4) "to curtail the purchasing power in the hands of the community and to prevent any further addition thereto."

While the policy must be considered as a step in the right direction, however late, it may be appropriate to make a few suggestions to indicate the directions in which the actual measures fall short of the minimum requirements embodied in the Report of the Economists who were specially consulted by Government in this connection.

Balanced or Surplus Budgets

It has been decided that the possible deficit in the budgets of the Central and Provincial Governments during the current financial year should be reduced as far as possible and that for the following year efforts should be made to

have surplus budgets. Towards this end, all avoidable expenditure will be postponed. A Committee of the Cabinet will determine the relative priority of schemes of development with a view to postponing or slowing down expenditure on schemes which are not productive and which could be postponed without difficulty.

In this connection the Economists had suggested the avoidance of deficit financing, i.e., keeping the expenditure of both the Central and Provincial Governments on revenue and capital accounts within revenue resources plus genuine loans. By way of an automatic check the Economists had further suggested that there should be a ceiling to the issue of notes by the Reserve Bank. Whereas the policy laid down by Government may achieve some desirable results, it is not clear whether deficit financing will be avoided. It is obvious that some deficit will arise at the end of the current financial year; the present indications are that it will be quite large. At the same time, it is not clear from the suggested measures how surplus budgets can be provided in the following financial year. More drastic steps may be required to curtail expenditure and avenues for more revenue other than those suggested in the statement may have to be tapped, if the goal envisaged in the statement, viz. surplus budgets from next year, is to be reached.

Provincial Finance

The Provincial Governments have been informed that they cannot expect any financial help from the Centre, so far as the expenditure for schemes of abolition of Zamindari and Prohibition are concerned. If they raise loans for these purposes, such loans should not interfere with the borrowing programme of the Central Government. Further they should add to their revenue resources by the levy of an agricultural income-tax where it is not already levied. At the same time the Estate Duty Bill will be proceeded with without delay. The entire proceeds from the levy of this duty will go to the Provinces.

The warning given to the provinces is good so far as it goes. If however we take into account the Prohibition plans of some of the Provinces, which were hailed with great publicity in the last week of September, it appears that this warning, which was known to the Governments concerned, has had comparatively little effect. Some of the Provincial Premiers have openly made statements which show that they do not understand the relation btween schemes of this type and inflation. Prices do not have provincial boundaries; they are highly sensitive and an all-India co-ordinated policy is required, if the goal laid down by the Government to prevent the rise in prices and to reduce them to reasonable levels is to be realised. In spite of the warning given, if some of the Provincial Governments get into serious difficulties some time later, it will not be possible for the Central Government to look on. In view of such possibilities, the freedom to the Provinces in connection with the above schemes may result in situations likely to cause difficulties.

So far as the additional taxation is concerned, besides the receipts from Agricultural Income-tax and Estate Duty, a surcharge on land revenue requires serious consideration. The incidence of the existing land revenue, fixed for long periods, has become relatively low because of the higher money receipts which the agriculturist-producer receives under the present conditions. It is justifiable, therefore, to ask him to contribute a part of his unearned increment to help in the present emergency.

Loans

The campaign for small savings is to be intensified and more facilities are to be afforded to the small investor by increasing the limit of deposits in Post Office Savings Bank and the amounts which could be invested in National Savings Certificates. Institutional investors seeking short-term investments will be given facilities to invest in Treasury Deposit Receipts on favourable terms for 6, 9 and 12 months.

In this connection, it may be mentioned that some form of compulsory savings could be introduced with advantage. Bonuses to workers in factories and employees in offices could be given in the from of Cash Certificates. Similarly, undistributed profits of companies, in excess of dividends which are now limited, should be kept as compulsory deposits with Government.

Industrial Production

The following steps will be taken to encourage industial production:—(1) The existing rules regarding the allowance of depreciation on plant and machinery for income tax purposes will be liberalised. (2) New industrial undertakings will be exempted from income-tax for some time. (3) Imports of raw materials and plant and machinery for industrial purposes will get a relief in customs duty. This may have desirable effect on the psychology of industrialists who may be induced to put forth more energy into their work than hitherto. It must however be pointed out that this is not likely to have any substantial effects on production in the immediate future.

Limitation of Dividends

It has been decided that in the case of public companies the amount distributed as dividends should not exceed the average for the two years ending with 31st March, 1948 or 6% on paid up capital, whichever is higher. At the same time, the repayment of the E.P.T. Deposits and of refundable E.P.T. will be postponed by three years, except in special cases.

The limitation of dividends to the average of two years ending with 31st March 1948 or 6% on paid up capital, whichever is higher, may be all right to begin with. It may however be necessary to make a detailed investigation into the amounts of dividends declared by the various companies during the years 1946-48, and to ascertain the average dividend which is thus likely to be declared in the case of existing companies. It may be found in some cases

that the dividends thus arrived at may be unduly high, and may not be consistent with the "policy of increasing the financial resources available for industrial development and at the same time for preventing additions to existing purchasing power". It is to be hoped that Government will make timely changes in such matters as soon as the necessary information is obtained to suit their fundamental policy.

Industrial Disputes

With a view to bringing about uniformity in the settlement of industrial disputes and Awards of Industrial Courts and similar authorities under the general control of the Central Government, legislative measures will be taken.

While the above suggestion is a step in the right direction, the necessary legislation and other steps are likely to take some time. It would therefore have been desirable to put a ceiling on wages corresponding to the ceiling on profits, as part of the general policy to prevent a further rise in prices and to reduce them to reasonable levels. Such a measure would be justified under the present emergency. Trade Union leaders and industrial workers should realise that it is to their interest to co-operate in lowering prices, which will automatically increase their real wages in terms of goods, instead of demanding higher money wages.

Restriction on Credit

The Reserve Bank has recently been given power to regulate the grant of advances by banks. It is proposed to make arrangements to see that this power is utilised to prevent speculation in commodities.

The suggestion of Economists that all banks should be required to hold Government securities to the extent of 25 per cent of their total demand liabilities, with certain exceptions, would have provided a healthy check on bank credit.

Controls

Government hopes to bring about a marked decline in the present level of prices and a better distribution of food grains and cloth by means of its new policy of controls on food and textiles. Proposals are under consideration for the reduction of the price of sugar and a better distribution of essential commodities like kerosene, iron, steel and cement.

Whereas the general policy regarding price control of certain essential commodities and better distribution of the same is satisfactory, it appears that the actual working out of the policy is likely to take some time. In order to avoid the continuation of the existing difficulties these measures should be expedited. At the same time, they should be made fool-proof against corruption and maladministration if the real benefits of these measures are to be received by the people at large.

Some Omissions

Among the major omissions in the statement are the absence of any reference to (1) increase in food production, (2) control of imports and exports with a view to help the anti-inflationary policy and above all, (3) the machinery for co-ordination of anti-inflationary measures as between the departments of the Central Government and between the Centre and the Provinces.

Co-operation of the Public

The fight against inflation involves interference in the normal economic life of the people in many directions. Some sacrifice has to be undertaken by all classes of people according to their capacity. Unless people realise the need for such sacrifice as well as for the necessary co-operation with Government in carrying out the various measures, there will be difficulties in implementing the same. In order that the various agencies of Government may have the necessary awareness of the problem in their day to day

work, and in order that the people may be roused to a conscious spirit of co-operation, it is desirable that all parties concerned should realise that the country is almost on a war economy in its fight against inflation, involving a life of austerity and sacrifice for some time, in the interest of achieving a healthy economic equilibrium for the country as soon as possible. If adequate steps are taken by the national leaders to arouse the necessary spirit, it would be possible for them to embody some of the measures suggested above in their policy and make it more effective.

POST-SCRIPT

Anti-inflation Measures in Operation *

The above discussion is a review of the anti-inflationary policy which the Government of India announced on 4th October 1948. This was written soon after the announcement was made. Since then about 6 weeks have elapsed at the time of writing this. † It is proposed in this post-script to review briefly the concrete measures that have been evolved so far, or are known to be in the making, to implement this policy. The object is to ascertain the trend of events so that we may be able to assess more accurately the nature of the anti-inflation policy in practice.

Balanced Budgets

So far as the budgets of the Central and Provincial Governments are concerned the principle of balanced or preferably surplus budgets has been accepted. Though it is too early to ascertain whether the budgets of the different Governments at the end of the current financial year will show a balance or deficit, we may refer to certain broad tendencies. Though the settlement of the Hyderabad problem is a welcome relief to the Central Exchequer, the

* This is based on an article contributed to the 1948 Annual Number of the *Indian Finance*, Calcutta. Thanks are due to the Editor of *Indian Finance* for his consent to use the same.

† 20th November, 1948.

continuation of the struggle in Kashmir must involve the Central Government in a continuous drain of resources. The refugee problem is not yet fully solved and it has raised its ugly head once again in the form of the exodus of Hindus from East Bengal. The expenditure on this account is likely to continue during the year and perhaps in the following year also. So far as the expenditure on food is concerned, we have to continue to import food at high prices on account of local scarcity. As the Government cannot recover the price paid by it fully, the loss on this account is treated as a food subsidy to the poorer classes of people. This item of expenditure is also not likely to be reduced. The only reduction that has been promised is some retrenchment in the establishments of the different Ministries of the Central Government. Barring occasional brief announcements of the working of the Economy Committee, we are not yet aware of the exact nature of their recommendations, much less of the extent to whcih these recommendations are likely to be implemented. Taking the situation as a whole, though some efforts at preventing reckless expenditure are being made, there does not seem to be enough indication of that serious and concerted effort to bring the Central Budget under control that is expected under the present circumstances.

So far as the Provincial Governments are concerned, perhaps it may be said that on the whole they show less awareness of the seriousness of the problem than the Central Government. Some provinces like the C.P. and West Bengal have wisely decided to go slow with their Prohibition Policy. No one expects the provinces to give up their principles. What is expected is that, because on financial grounds the Provinces cannot afford at the moment to incur large deficits, a temporary postponement or slowing down of the policy will be done. In spite of it, other provinces like Madras and East Punjab have decided to go headlong with their Prohibition Policy though this would involve serious loss of revenue and perhaps additional expenditure to prevent illicit manufacture and sale of liquor.

The warning of the Central Government that they will not help the Provincial Governments, in case they get into difficulties on account of their schemes of Zamindari abolition and Prohibition, has little significance, because it is possible for some Provinces to argue that they do not want any help for these specific schemes. They may however get into other difficulties by using up their resources on these schemes, and later on ask for help from the Central Government, which it may be difficult to refuse. If any of these Governments is faced with a serious famine or other calamity, and if it is not able to face the situation because its financial resources are exhausted on schemes of Prohibition or abolition of Zamindari, it would not be possible for the Central Government to look on; they will have to help in spite of their warning. It is suggested that if the Central Government means business, instead of a polite warning there should be a proper mandate requiring a uniform financial policy under the present circumstances. As mentioned before, both the Central and Provincial Governments have to realise that prices have no provincial boundaries and that control of prices and their reduction cannot be achieved by conflicting financial policies in different parts of the country.

Capital Expenditure

So far as capital expenditure is concerned, it is known that at the Conference of Finance Ministers held recently at Delhi, the Provincial Governments were asked to put into operation only those schemes that were immediately productive. The Government of India on the other hand themselves do not seem to have set a good example. It has been announced, for example, that arrangements are now being made to complete the Damodar Valley Project in 5 years instead of 10 years, as originally intended. Whereas what the Economists suggested would in practice have meant the completion of a scheme like this in 12 years instead of 10 by slowing it down in the early years, exactly the opposite is being sought to be done by those in charge

of this scheme. By concentrating the capital expenditure on this scheme in 5 years instead of 10 or 12, the effect in the immediate future must be the intensification of the inflationary situation. The same tendency is reflected in other directions, inasmuch as not a week passes without one hearing of some capital scheme or other having been taken in hand from this or that point of view. The Provincial Governments cannot be expected to take the advice of the Central Government seriously under the circumstances, and if they interpret it rather loosely, we need not be surprised.

The want of seriousness towards this problem so far as the Provincial Governments are concerned is also reflected in their attitude regarding the payment of compensation arising out of the abolition of Zamindari. Most of the Provinces concerned are eager to push on with this scheme and they hope to do so without involving themselves into financial complications. We wish them well if they can carry out their intentions. But one doubts whether this can be done easily without complicating the situation so far as the immediate future is concerned.

Ceiling on Dividends and Wages

The announcement regarding the limitation of dividends was well received by the business community, because in practice it is not likely to affect adversely the return on capital to which the business community is accustomed. In spite of this the paralysis in the capital market continues, as is indicated by the slump in the Share Market and by the difficulty of obtaining capital subscriptions. The absence of a corresponding limitation on wage increases has been taken advantage of and demands for higher wages or bonuses have already been made. If the expected check on the rise in prices has not been realised and instead, if the tendency towards high prices is still there, one cannot blame the worker if he wants a higher monetary return in order to be able to make both ends meet. In other words, this tendency reflects the weakness in the existing

policy which has not brought about that firm control on prices, which alone can inspire confidence among those interested.

Controls

In this connection, it may be appropriate to refer to the efforts at the extension of food and cloth control. Because the machinery of these controls was disbanded about a year ago, the Government are taking time to re-create the machinery; the actual controls are not yet in operation as announced and the victims of inflation continue to suffer. One may sympathise with the Government in their efforts to devise and institute the necessary machinery, but it is well to remind them that every day's delay in carrying out the policy adds to the unrest in the country among those masses of the people, whose capacity to suffer from the prevailing economic crisis is fast coming to an end.

Foreign Trade

So far as foreign trade is concerned, the recent announcement to increase import duties on some luxury articles was considered as a big step in the anti-inflationary drive. It should be pointed out that though this measure by itself is welcome, it is not likely to have any significant effect on the inflationary situation. Suggestions were made to the Government, particularly by Economists, that the foreign trade of the country should be regulated as an important plank in the anti-inflationary policy. What is necessary is that we should have more of essential goods not only by local production but also by imports. Unless essential goods are made abundant in the country their prices cannot be lowered. In order to obtain essential goods from other countries, we must utilise the principal means of payment that we have at our disposal, viz. our capacity to export certain goods. Bilateral agreements should be immediately entered into with other countries which can supply essential goods to us, by offering to them those of our exports which they are in need of. Unless the foreign trade of

the country is thus regulated and, in a similar way, unless the entire economy is geared to the anti-inflationary policy we cannot hope to have those desirable results, which the Government of India announced on the 4th of October as their objectives, viz. to ensure that there is no further rise in prices and in the cost of living and to bring about a progressive reduction in prices to reasonable levels.

Conclusion

This rapid review of the prevailing trends in the anti-inflationary policy indicates that (1) there should be greater awareness both in the Central and Provincial Governments of the serious and urgent nature of the problem; (2) that the economic and financial policy of the country should be fully co-ordinated between the Centre and the Provinces if it is to succeed; and (3) that there should be adequate machinery for a continuous watch over the prevailing tendencies by a systematic study and examination of the trends so that timely action may be taken. Unless the anti-inflationary policy is carried out with vigour and determination, and unless the people of the country are made aware of the crisis through which they are passing by the adoption of a proper outlook by the Governments themselves, we shall be far from achieving that economic equilibrium on which alone the foundations of sound economic progress for the country can be laid.

APPENDIX

SOME MONETARY FALLACIES

(As explained in the Preface, the object of this book is to enable the ordinary reader to understand and follow the problems created by the present economic crisis with interest. For this, he should have clear and correct ideas on the subject. As some incorrect ideas on the subject are current in influential quarters, an attempt is made in this appendix to indicate the fallacies underlying such ideas. For example, at a time when most people in the country are anxiously worried about the prevailing inflationary situation and when Government, on their part, are trying to devise ways and means to put a stop to this tendency, one would not take seriously any attempt at suggestions to the effect "that the situation is not serious, and that, on the contrary, there is need for a reflationary influence on our monetary policy" which means, a need for adding to the volume of currency and credit. Such a view, however, was expounded by Mr. G. D. Birla at the Annual General Meeting of the United Commercial Bank, Calcutta, in his capacity as Chairman of the Bank in April last. In view of the position which Mr. Birla occupies in the business world of this country, it is appropriate that the highly fallacious views that he has been propounding must be corrected in the interests of the country at large, lest the public in general and the business world in particular are misled by such views. It is not unlikely that his views had a great deal to do in creating that atmosphere which led Mahatma Gandhi to press for decontrol, a policy which has been proved wrong within a few months.

As the speech of Mr. Birla referred to above was not fully explanatory, I wrote to him for further information. I must acknowledge with thanks that he was good enough to supply this information, part of which was received from Mr. B. T. Thakur, General Manager of the United Commercial Bank. In order that the reader may have a connected idea of the points at issue, a brief statement is given in section (a) of the views of Mr. Birla along with the supporting statements supplied by Mr. Thakur. For using this material, I have received the consent of Mr. Birla.

In section (b) a brief note is given pointing out the arithmetical inaccuracy in the formula on which the arguments of Mr. Birla are based.

Ignoring this inaccuracy and taking the views of Mr. Birla as such, an attempt has been made in section (c) to analyse the same as briefly as possible. This analysis has been written, at my suggestion and in consultation with me, by my colleague, Dr. B. V. Krishnamurthy, Lecturer in Economics in this School. He has succeeded in pointing out the fallacies underlying Mr. Birla's conception in simple language and as briefly as possible.—C. N. VAKIL.)

(a) STATEMENT OF MR. BIRLA'S VIEW AND SUPPORTING DATA

Mr. Birla's Concept of Effective Money *

One hears a good deal of loose talk of inflation in our currency. The position is not at all bad as people imagine. The Bank's Statistical Department has constructed a curve of effective currency and bank deposits, from 1939 to 1947, which takes into account factors like prices, production, velocity of circulation and hoarding which so materially affect sufficiency or insufficiency of money.

* Extract from the Speech delivered by Mr. G. D. Birla, Chairman, United Commercial Bank Ltd. at the Fifth Ordinary General Meeting of the Shareholders held on Thursday, the 22nd April, 1948, pp. 10-13.

Effective volume of currency and deposits takes into account the following considerations:

(1) Volume of money must change according to prices, productive activities, velocity of its circulation and the size of its sterile part which remains outside the banking system doing no proper function in the economic set-up of the country.

(2) Maladjustment due to any of these influences disorganises money market.

(3) Bank rate in India being far from effective, explanation of actual monetary conditions is provided not by published figures of currency and deposits as they are, but by introducing proper adjustments with the forces operating thereon.

(4) Money's sufficiency or otherwise can only be judged in relation to its work and efficiency.

As no reliable index of production is available, we have taken representative groups of industries and tried to build up an index of their production. The speed of circulation of currency and credit has become much slower due to the partition of the country, reduced business, maldistribution and bottlenecks in communications. And there is greater portion of currency which is sterilized, and remains outside the banking system, than was the case before the war. An index of such sterile currency, called for the sake of brevity "hoarding index" has also been prepared and applied to the adjustment of the money curve.

Figures of currency and bank deposits mean very little in themselves. For correct appraisal, they must be studied not in vacuum but in the fields of their operations and in relation to work they do.

The fully effective curve of money gives a correct picture of money's potency. It is flat and nothing like the steeply ascending curve of unadjusted currency and deposits, to which one is apt to give undue importance in the scheme of real values and call inflation. We must also realize that we cannot go back to the conditions as they

existed before the war and stabilization of conditions has to be attempted at round about the present economic levels.

If interest rates are indicative of excess or deficiency in currency and credit, we seem to be passing through a deflationary phase because rates of interest in the market, as distinct from the unchanging and ineffective bank rate, have been continuously rising. In India market sensitivity is the real criterion of excess or deficiency of money and not the bank rate. The adjusted curve of money more closely approximates the actual monetary conditions than the misleading unadjusted curve of published figures of currency and deposits. The realities of the situation indicate that there is need for a reflationary influence in our monetary policy.

The Formula for Adjusted or Effective Volume of Currency and Credit *

To determine the potency or efficacy of money the existing volume of currency and deposits is adjusted in the following manner for various factors:

(1) **Credit Velocity.** This operates in an inverse manner. The greater the velocity the smaller the need for money. Adjustment factor to be applied to money is:

$$\frac{\text{Index of Credit Velocity}}{100}$$

, 100 being the basic index of credit velocity for the basic date.

(2) **Prices.** Higher the prices, greater is the need for money. To determine the sufficiency or insufficiency of money as compared to the basic date, the multiplying factor would be

$$\frac{100}{\text{Price Index}}$$

* Compiled from Mr. B. T. Thakur's letter to Prof. C. N. Vakil, dated 17th June, 1948, and The Note in Amplification of the Data given in Chairman's Speech delivered on 22nd April, 1948, The United Commercial Bank Ltd.

(3) **Production.** Production index also operates in the same manner as prices because greater the production the greater is the need for money. Therefore the multiplying factor would be

$$\frac{100}{\text{Production Index}}$$

(4) **Hoarding.** This too operates in the same manner as factors 2 and 3 because greater the hoarding i.e., withdrawal of money from active circulation into inactivity, greater would be the need for money. The multiplying factor is:

$$\frac{100}{\text{Hoarding Index}}$$

Final Formula. When all the above factors are applied to the volume of money, "M", the formula would be

$$\frac{\text{M x Index of Credit Velocity}}{\text{Price Index x Production Index x Hoarding Index}} \text{ X } 10^4$$

$$\left(10^4 \text{ is a convenient way of writing } \frac{100 \text{ x } 100 \text{ x } 100}{100}\right).$$

Table pertaining to adjusted or effective volume of currency and credit

Year	Wholesale Price Index 1939=100	Production Index (a) 1939–40 =100	Credit Velocity Index (b) 1939–40 =100	Hoarding Index (c) 1939–40 =100	Notes in Circulation	Scheduled Bank Deposits (Rs. crores)	Volume of Currency & Credit (6) + (7)	Adjusted or Effective Vol. of Currency & Credit (d)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1939–40	125.6	100.0	100.0	100	198.13	234.59	432.72	344.5
1940–41	114.8	106.9	77.9	106	228.03	256.98	485.01	290.4
1941–42	137.0	114.8	76.6	113	28[illegible].48	303.50	590.98	254.7
1942–43	171.0	110.9	57.8	149	51[illegible] 44	410.49	923.93	189.0
1943–44	236.5	111.2	59.0	157	77[illegible] 17	599.41	1376.58	196.7
1944–45	244.2	110.6	56.8	149	968 [illegible]9	778.92	1747.61	246.7
1945–46	244.9	111.9	58.8	153	1162.64	914.05	2076.69	291.2
1946–47	275.4	106.9	62.4	141	1222.96	1048.11	2271.07	341.4
1947–48	300.7	102.8	57.0	141	1228.69	1059.71	2288.40	299.3

(b) ARITHMETICAL ERROR IN THE FORMULA

That Mr. Birla's concept of Effective Money is entirely meaningless will be demonstrated in detail in the next section. The purpose of this section is merely to point out that there is an arithmetical error in the formal derivation of the formula and that actually the formula does not bring out the meaning it is intended to serve.

The method adopted in deriving the formula is nothing but a mechanical application of the Rule of Three. But the Rule of Three is being applied to establish relationship between an index number on one side and a corresponding quantity of money on the other. Now quantities of money are *concrete* entities whereas index numbers are *pure* numbers. They are abstract and in order that they may attain concrete values, appropriate units of measurement have to be affixed. Only then could the Rule of Three be applied. It is possible however to affix the relevant standard units of measurement to these pure numbers so far as the indices of production, hoarding and velocity are concerned. But it is impossible to affix the relevant monetary unit for the price index. For, the value of the unit keeps on changing and at any point of time its value is the reciprocal of the general price level at that moment. In fact, every form of index number for prices (which are pure numbers) implies a correlative form of index for trade which is concrete, being expressible in rupees and annas. Therefore to apply the Rule of Three with regard to price index and quantity of money is an elementary arithmetical error.

Moreover, the "effective money" formula merely provides an *imaginary* quantity of money for each year, given the actual quantity of money and the index numbers of prices, production, credit velocity and hoarding. This imaginary quantity is the amount of money that would be necessary in each year under conditions when the indices of prices, production, hoarding and velocity conform to their base value, in order that money may perform an

amount of work identical to that performed by the *actual* quantity of money during the same year under conditions indicated by the indices of prices, production, hoarding and velocity as shown in the table. It is obvious that this is a purely fictitious quantity that is arrived at by mere arithmetical manipulation. It makes little sense in the analysis of the effects of *actual* supply of money on the economic activity. The formula can by no means stand the interpretation imposed on it by Mr. Birla in order to arrive at his conclusions.

(c) MONETARY FALLACIES OF MR. BIRLA

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In the present context when there is the greatest possible agreement of opinion regarding the dangerous inflationary trends in the country, Mr. G. D. Birla stands unique in upholding an exactly opposite viewpoint.* According to Mr. Birla: "One hears a good deal of loose talk of inflation in our currency. The position is not at all bad as people imagine. ....The realities of the situation indicate that there is need for a reflationary influence on our monetary policy."† This stand taken by Mr. Birla is quite in keeping with his general attitude to the monetary problem right from the beginning of the last war. To that extent it provides no surprise. But what is surprising is the invention of a new concept which he calls "effective or adjusted money" in defence of his conclusions.

Mr. Birla maintains that: "Figures of currency and bank deposits mean very little in themselves. For correct appraisal, they must be studied not in vacuum but in the

* G. D. Birla : Speech delievered at the Fifth Ordinary General Meeting of the Shareholders of the United Commercial Bank, April, 1948.
† Ibid., pp. 10-12.

fields of their operations and in relation to work they do. The fully effective curve of money gives a correct picture of money's potency. It is flat and nothing like the steeply ascending curve of unadjusted currency and deposits, to which one is apt to give undue importance in the scheme of real values and call inflation." † While there has been an expansion in the *actual* volume of currency and credit from Rs. 433 crores in 1939-40 to Rs. 2,288 crores in 1947-48, Mr. Birla's "adjusted or effective volume of currency and credit" shows a decline from a sum of Rs. 344 crores in 1939-40 to Rs. 299 crores in 1947-48. Further, Mr. Birla's diagram indicates that, whereas the actual volume of currency and credit has been continuously expanding, amounting to five times the 1939-40 figure, in 1947-48 and throughout this interval, the "effective or adjusted" money stood below the 1939-40 figure. This means that, contrary to the commonsense observations, there has actually been a shortage of "effective money" in the war and post-war years. Further, it is interesting to note that in 1947-48, for instance, out of an actual volume of currency and credit amounting to Rs. 2,288 crores, the "effective volume" turned out to be only Rs. 299 crores. This suggests that during that year, nearly Rs. 2,000 crores disappeared or were rendered ineffective. One is frankly puzzled how such a thing could ever happen. But an answer is provided by the application of a formula which, again, appears to be a convenient invention on the part of the Statistical Department of the United Commercial Bank. ‡

Mr. Birla's Concept of "Effective Money"

If this concept of "effective money" were to prove meaningful, it would as well mean that what we have learnt so far in monetary theory and practice has to be unlearnt at once. Since no one could be expected to adopt

† Ibid., p. 11.
‡ Ibid., p. 10.

such a course unquestioningly, it is appropriate to examine this concept of Mr. Birla. A careful analysis, however, reveals that, apart from the concept being meaningless, its acceptance in practice would be followed with disastrous consequences.

Mr. Birla argues that an explanation of actual monetary conditions is provided not by published figures of currency and deposits as they are, but by introducing proper adjustments with the forces operating on them. According to him, these forces are prices, productive activity, velocity of circulation of money and the size of the sterile part of money which remains outside the banking system.* The formula† for deriving this "adjusted or effective volume of currency and credit" is

$$\frac{\text{Volume of currency and deposits} \times \text{Credit velocity index}}{\text{Price index} \times \text{Production index} \times \text{Hoarding index}} \times 10^4$$

There is an elementary arithmetical error even in the formal derivation of this formula; and, actually, the formula does not bring out the meaning it is intended to serve. But this need not detain us here. For, we are primarily interested in examining whether this process of "adjusting" the actual volume of currency and credit in order to measure the "effectiveness" or "potency" of money is correct. Having stated our purpose this way, it would be worthwhile to elucidate the meaning of effective money as generally understood by the students of this subject.

All currency and credit made available to the community are effective. The extent of effectiveness within a given period of time depends, however, on the rate of turnover of a given supply of currency and deposits in that period, i.e., their respective velocities of circulation. The

* Ibid., p. 12.

† Note in Amplification of the Data given in the Chairman's Speech at the United Commercial Bank, April, 1948.

total supply of effective money is given by: Currency X its velocity of circulation *plus* average circulating deposits X its velocity of circulation. What increases the effective supply of a given volume of money is the increase in its velocity of circulation and what reduces the effective supply is the presence of hoarding. But analytically the two statements mean the same thing. For, increase in hoarding merely means decrease in velocity. The two are precisely inverse to each other.

Mr. Birla's Reasoning Examined

In the light of the above explanations we may systematically examine Mr. Birla's reasons * for "adjusting" the volume of money.

Mr. Birla's formula assumes that, if prices are high, we need greater volume of money to perform the same amount of work in the matter of exchange and distribution of goods. This is inverting the fundamental cause-effect relationship between money and prices. In doing so, the crux of the inflationary problem, namely, why prices are rising high, is deliberately assumed away. In fact, this is made the cause for demanding a further expansion of money. That such a process of "adjusting" the supply of money would be fraught with disastrous consequences becomes clear from the following discussion.

High prices for certain commodities might exist owing to their genuine scarcity of supply relative to a growing demand. A rise in price on such an account is perfectly natural and is the normal way of restoring equilibrium conditions in the market for such a commodity. But so long as the total supply of money is constant, such price rises in some commodities must necessarily mean a price fall in other commodities or assets. The general price level can

* The following reasons in defence of the "Effective money" formula are advanced by Mr. B. T. Thakur in his letter to Prof. C. N. Vakil, dated 17-6-1948.

be said to remain unaltered owing to such changes. And what matters primarily in an analysis of the value of money is the general price-level.

The absolute height of the initial general price-level is again a matter of indifference. It makes no difference whether the initial level is high or low. For, the initial height is only an historical accident. What is of great importance is the change in price level which is broadly taken to indicate the change in the value of money.

Causes of Rise in Prices

The general price-level may tend to rise, even though the effective supply of money is constant when there is a contraction in the total volume of production or, in other words, the aggregate output. Such a situation is, in reality, unlikely, for a contraction in volume of production is invariably accompanied by a diminution in the total supply of money. This point apart, judging from Mr. Birla's table of Production index, the rise in price-level under discussion cannot be accounted for in terms of changes in the volume of production. For, while the price-level in 1947-48 rose to three times its base value, the production index for that year showed practically no change whatsoever from its base value. As a matter of fact, in the entire period from 1939-40 to 1947-48, whereas the production index in no year fell below its base value, the price-level showed a continuous rise. This means that right from the year 1939-40, the rise in price-level is caused by factors other than changes in the volume of production. A glance at Mr. Birla's table showing the growth of the *actual* volume of currency and credit will make it evident that the continuous rise in price-level is predominantly due to an increase in supply of money. In 1947-48, for instance, while the price-level rose to a figure three times its base value, the volume of currency and credit in that year amounted to nearly five times the quantity in the base year. When this is the case, it is obvious that any additional expansion

of money would only lead to a further rise in prices. But this is just what Mr. Birla wants.

For, to Mr. Birla, successive increments in price-level call for successively increasing supply of money in order that money supplied may "efficiently" perform its function. The logical conclusion would be to recommend an indefinite expansion of money in order to support a perpetually rising price-level. Mr. Birla believes in aggravating the cause in order to eliminate the effect. The absurdity of such a course follows from Mr. Birla's inversion of the cause-effect relationship between money and prices.

Changes in price-level are always effects of changes in other economic quantities such as volume of money, and aggregate output. Price-level by itself cannot cause economic changes in the sense that it cannot initiate any such changes. Price-level, on the contrary, is the medium through which the adjustments or maladjustments between different economic quantities are brought about. It is principally an indicator of the state of underlying economic relations.

Fundamentally Wrong

It is obvious that Mr. Birla is fundamentally wrong in making a rise in price-level a plea for further expansion in the supply of money. His argument would very much resemble a case where, just because the room is already over-heated, a greater supply of fuel is called for in order that fuel "may perform the same amount of work."

Mr. Birla's formula further assumes that credit velocity operates in an inverse manner; that the greater the velocity the smaller the need for money. No doubt such a proposition is made use of to illustrate the point that, other things remaining equal (i.e., the demand for money remaining constant), the total supply of money can be kept constant, even though the velocity of circulation is falling, by means of a proportionate increase in the quantity of money, and *vice versa*. This inverse relationship can be assumed for purposes of analytical presentation. But it is an observed

fact in monetary history that volume of money and its velocity of circulation are seldom compensatory in their movement. The two move together in the upward direction in times of prosperity and in the downward direction in times of depression.

This observation, however, does not hold true with regard to the actual war-time and post-war experience in our country. Mr. Birla's table significantly bears out this point. While there has been a continuous expansion in the volume of Scheduled Banks' deposits since 1939-40, the Credit velocity index shows more or less a continuous decline. Whereas in the base year 1939-40, the volume of bank deposits amounted only to Rs. 235 crores, in 1947-48, the volume of bank deposits rose to Rs. 1,060 crores but the credit velocity index fell from 100 to 57. Mr. Birla readily infers from this that the decline in credit velocity has to be made up by a proportionate expansion in bank deposits in order that "money may perform its function efficiently." The absurdity of such a course becomes apparent if we realise that a decline in credit velocity merely means an increase in hoarding of credit. As long as this decline persists, an increased supply of money would only lead to an increased amount of hoarding.

Mr. Birla's Concept of Hoarding

This brings us directly to the problem of hoarding; and Mr. Birla has some peculiar ideas on this problem. He defines hoarding as "the sterile part (of money) which remains outside the banking system doing no proper function in the economic set-up of the country". The deterioration in the relationship between deposits and currency is said to measure the extent of increase in hoarding. Mr. Birla's table includes a hoarding index with 1939-40 as the base year which indicates that there has been a significant increase in hoarding during the war-time and the post-war period. And to Mr. Birla, the greater the hoarding (i.e., the withdrawal of money from active circulation into inactivity), the greater the need for additional money "in

order that money may perform its work efficiently". Once again, Mr. Birla believes in aggravating the cause with a view to eliminate the effect.

The complacence with which Mr. Birla advances this peculiar argument may persuade the unwary layman to believe in its correctness. Mr. Birla wants us to believe that this hoarded money, which amounts to a pretty big sum even according to conservative estimates, is sterile and performs no function. Nothing can be farther from the truth. As a matter of fact, much of the anomaly in the economic affairs of the country to-day could be largely attributed to the *vicious* element of hoarding. It is, therefore, of interest to examine the arguments of Mr. Birla, who obviously sees nothing wrong in hoarding and believes that an increase in hoarding can be made good by an expansion of money.

Mr. Birla defines hoarding as the sterile part of money which remains outside the banking system. Such a definition is not wholly correct, because some money lying within the banking system may also constitute hoarding.

In the general sense of the term, an individual is said to hoard when he holds his assets in the form of money. In this sense the total amount hoarded at any time by the community must be equal to the total quantity of money. "Holding money" and "hoarding money" are thus synonymous terms. And since all the money in existence at any moment of time must be held by somebody—either the public at large or the banking system—all the money is always hoarded. If the total quantity of money is kept constant, there can be no increase whatsoever in the aggregate amount hoarded. Mr. Birla obviously does not use the term in this sense.

In the strict sense of the term, hoarding is defined as the quantity of money held *minus* what is required for transaction purposes. In other words, it is idle or inactive money including notes, coins and deposits or whatever is regarded as money. Net hoarding or dishoarding in this sense merely means an increase or decrease of idle balances.

It is termed idle, because this money is held for purely speculative purposes and is not used for transactions relating to production and distribution of goods and services. An increase in hoarding may come about, even though the total quantity of money is constant by a decline in incomes and trade activity, which releases money from active circulation. Therefore "an increase in hoarding" is merely another name for a fall in the average velocity of circulation of money. Mr. Birla is evidently using the term in this strict sense.

But *idle* money does not mean that it is sterile. In fact, no part of money is sterile, unless it is declared illegal by a fiat of the Government. The vast sums of money which are being held by the public are to a great extent *idle* in the technical sense of the term (viz., speculative balances). But these sums of money are by no means sterile. On the contrary, they are too much virile. It will be presently argued how they are responsible for many maladjustments.

Mr. B. T. Thakur observes: "Withdrawal of money at one time was caused by black marketeers keeping huge amount of money locked up in safes . . .Money so withdrawn or hoarded, which in the aggregate must be very large indeed, is lost to the market".* It would strike the meanest intelligence that this money, "which must be very large indeed", is not lost to the market; on the contrary, it constitutes the biggest menace to the market. This is exactly what we describe as the inflationary potential; and we have been increasingly feeling its effects ever since the control on essential commodities was removed in December 1947.

Consequences of Mr. Birla's Theory

If we were to follow up Mr. Birla's "effective money" theory, we have to increase the supply of money as a part of the programme in bringing about proper economic adjustments. We have to do so because prices are rising, because velocity is falling, because there is an increase in

* Letter to Prof. C. N. Vakil.

hoarding. We have seen that thereby, on each of these accounts, we shall be feeding the cause that is responsible for the effect. The actual outcome of such a course would be a further rise in price-level, a further fall in velocity and a further increase in hoarding, each proceeding at an accelerating pace and money perpertually chasing each of them. The practical implications of Mr. Birla's theory are nothing but adding fuel on all sides to a house already set on fire.

Need for Anti-Inflationary Measures

Mr. Birla's concept of "effective money" is erroneous, because the reasoning process behind it is radically wrong. When it is evident that expansion of money has been greatly responsible for high prices and hoarding of money, the first step in the right direction is to stop further expansion of money. It is a source of great satisfaction to the country that the Reserve Bank has recognised the supreme need for disinflation, and the Government of India are seriously considering measures to prevent inflation.

The increase in note circulation since the end of the war uptil March, 1948, is about 165 crores of rupees, which is a comparatively small rise compared with the rate at which currency expanded during the war. But the index number of agricultural commodity prices moved from 303.5 in August 1945 to 402.4 in March, 1948, and the general price index moved from 271.3 to 343.6 in the same period. It is obvious that the rise in prices has been terrifically out of proportion to the increase in volume of currency in this short period. Any further delay in introducing effective counter-measures would in no time land us into a state of hyper—or runaway inflation.

In addition to this increase in volume of currency, the depletion of Government's balances with the Reserve Bank to the tune of Rs. 244 crores since May, 1946, has been a reinforcing factor of considerable importance, on the monetary side, to the present inflationary condition. But it would be a grave mistake to give too much importance to this factor in explaining the present muddle. To do so

would be to ignore the most powerful cause viz., hoarding.

The chain of anomalies we are faced with, particularly since the end of the war, could be clearly seen from the following table.

Price Index

Commodities

(Base: Week ended August 1939 = 100)

		Agricultural	Manufacturing	General
August 1945	..	268.0	243.5	244.1
1945-46	..	272.6	240.0	244.9
1946-47	..	313.8	259.1	275.4
1947-48	..	356.9	287.8	307.0
June 1947-48	..	..	..	366.9

Securities

(Base: 1927-28 = 100)

		Government	Fixed yielding	General
August 1945	..	118.0	187.7	212.6
1945-46	..	118.6	187.0	220.8
1946-47	..	120.4	197.8	268.6
1947-48	..	117.2	169.9	191.9
June 1948	..	114.7	159.2	164.9

Gold

(Price per tola in rupees)

		Highest			Lowest			Average		
		Rs.	a.	p.	Rs.	a.	p.	Rs.	a.	p.
1945-46	..	97	12	0	63	6	0	80	3	0
1946-47	..	111	0	0	84	4	0	101	1	2
1947-48	..	117	12	0	95	14	0	108	0	4

Commodity prices are rocketing, particularly after decontrol. Security prices are woefully sagging and gold prices are shooting up in spite of significant net import surplus since the last two years. One would be justified in

guessing that a large part of this demand for gold is being backed up with black market gains.

Bullish Errors

The rapid decline in security prices may be attributed to a considerable extent to the uncertain economic policy of the Government and the genuine difficulties of production such as shortage of capital goods and transport bottle-necks. But these, however, are not the major causes. The correct explanation would be revealed if one were to study the spectacular rate at which security prices shot up in the first part of 1946-47.

Index Numbers of Prices of Indian Securities

(1927-28 = 100)

1946-47	General Index
April	259.8
May	267.3
June	280.9
July	303.8
August	314.9
September	282.0
October	265.5
November	264.6
December	252.6
January	256.3
February	239.3
March†	..

The index reached its peak figure of 314.9 in the month of August, 1946. But the latter part of the year marked an equally spectacular decline in security prices. The decline, however, has come to stay; and the downward trend has been continuous, barring the brief reversal in December, 1947, because of Mr. Shanmukham Chetty's budget. But this swing to the downward direction was an

† Indices for March 1947 were not compiled as the Stock Exchanges remained closed for most of the period.

inevitable consequence of the artificial boom conditions in the early part of 1946-47. There was no basis whatsoever for such exaggerated estimates of investment yields. The downward drift is the natural process through which the stock market tends to correct itself of its bullish errors. To this extent, the decline in the security prices need cause no alarm, since it is but right that the market should provide a correct estimate of the real investment yields in the country. But, all the same, the sagging of the security prices calls for serious attention, because prices may fall beyond their normal level and thereby generate conditions for pessimism and decline in investment. Moreover, the inverse movements of commodity prices and security prices are an indication of serious maladjustment in the economic affairs of the country. Its effects could be clearly seen in the fact that speculative holdings of commodities are proving to be a much more attractive proposition to the ordinary business man than holdings of securities. This takes us to perhaps the most important factor behind the present maladjustment, viz., intense speculation in commodity markets.

The nature of present speculative buying of commodities could be seen from the fact that, whereas the price index, agricultural as well as general, was showing a decline since August 1947, there was a sudden rise in December 1947, and, since that time, the price index, both agricultural and general, has been showing a rise at a terrific tempo.

Price Index

(Week ended 19th August 1939 = 100)

	Agricultural	General
August, 1947	351.8	299.3
September, 1947	346.6	298.0
October, 1947	347.0	298.2
November, 1947	340.7	296.7
December, 1947	363.2	311.6
January, 1948	386.4	333.4
February, 1948	388.8	341.8
March, 1948	402.4	343.6

This makes it evident that the removal of controls in December, 1947, provided a powerful start to commodity speculation. Since then, the speculative buying in the commodity market is increasing at an alarming rate. The reasons are obvious.

Since the time of decontrol, there has been a remarkable flight from currency to goods on the part of the public, arising out of expectations of further rise in prices. This is in addition to the well-established fact that the total real demand for essential commodities on the part of the entire community has remained constant, if not actually increased. Add to this the increase in pressure over the commodity markets due to the refugee influx, and we get to know why commodity speculation has become highly attractive. This undiminished demand, in spite of rising prices, has enabled the wholesalers and producers to fix the reserve prices very high. And it is the accumulation of huge sums of hoarded money that has provided the most powerful prop to the speculative holders in strengthening their waiting capacity. It is the war-time inflationary potential, again, that has been responsible for this commodity speculation. The flight of money from the capital market to the commodity market is as yet really not so big as it is popularly believed. It may be a fact that the marginal investor has withdrawn from the capital market and has begun investing in commodity speculation. Again, a good section of the commercial banks may have reduced lending for stock exchange speculation and considerably increased lending towards speculative buying of commodities. But these, however, are not so significant, when compared to the support given by the existence of huge sums of hoarded money. And the commodity speculator is having at the present moment the chance of making "a hay of his lifetime."

In this distressing background of our economic situation, it sounds like the "irony of it all" that Mr. Birla should come forward with the statement that hoarding is sterile part of money, and that money hoard[illegible] lost to the mar-

ket. The extravagant consumption on the part of the rich and the new rich has by no means brought about any substantial reduction in the size of the aggregate hoarded money. Disinflation by itself would bring very little good, if the present pattern of money holdings is left untouched and commodity speculation is allowed to run riot.

The situation calls for urgent Government intervention. But the intervention sought for is of a type which is the exact opposite of Mr. Birla's suggestions. It has to be directed towards rooting out the causes which Mr. Birla wants to feed. If the objective is to bring about proper adjustments in the economic sphere, disinflation could only be the first step. It has to be instantaneously followed up with an effective control over prices of essential commodities, with an outright mopping up of the excessive hoards of the rich, with varied but vigorous measures that would eliminate unnecessary consumption on the part of the entire community and transform these hoards, wherever they are and however small, into useful savings that would finance productive activity.

ERRATA

Page	Para	Line	
18	2	7	for "effect on the loss" read "effect of the los
25	2	3	for "wheat high" read "wheat as high."
41	2	9	after "in view" delete "of."
44	1	3	After "India" insert "would."
48	2	4	for "though" read "thought."
66	2	4	"buy a large" read "buy large."